

MINDBODY, Inc.
Form 10-Q
November 08, 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 September 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: 001-37453

MINDBODY, INC.

(Exact name of registrant as specified in its charter)

Delaware 20-1898451
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
4051 Broad Street, Suite 220
San Luis Obispo, CA 93401
(Address of principal executive offices)(Zip Code)
(877) 755-4279
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 Small 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

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

As of November 5, 2018, the registrant had 45,401,442 shares of Class A common stock, and 2,517,684 shares of Class B common stock outstanding.

Table of Contents

	Page
PART I. <u>FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements (Unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017</u>	<u>5</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2018 and 2017</u>	<u>6</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the Three and Nine Months Ended September 30, 2018 and 2017</u>	<u>7</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2018 and 2017</u>	<u>8</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>9</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>32</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>43</u>
Item 4. <u>Controls and Procedures</u>	<u>43</u>
PART II. <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>45</u>
Item 1A. <u>Risk Factors</u>	<u>45</u>
Item 6. <u>Exhibits</u>	<u>71</u>
<u>Signatures</u>	

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “possible,” “continue” or the negative of these words or other similar terms or expressions that concern, among other things, our expectations, strategy, plans or intentions. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, results of operations and prospects. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our ability to grow revenue and/or maintain our revenue growth rate by adding new customers, retaining and deepening relationships with existing customers, growing our consumer user base and increasing transaction volume across our two-sided marketplace of wellness;
- our ability to scale and adapt our existing technology in a timely and/or effective manner;
- the effects of the evolving regulatory framework for privacy, security and data protection on our platform;
- the effects of price changes for our products and services;
- benefits associated with use of our products and services;
- our ability to introduce, develop or acquire new products and services, improve our existing products and services and increase the value of our products and services;
- the network effects associated with our business;
- our future financial performance, including expectations regarding trends in revenue, cost of revenue, operating expenses, other income and expenses, and income taxes;
- our future key metric performance;
- our ability to further develop strategic relationships, including our ability to increase or maintain our revenue from our API and technology partners;
- our ability to strengthen or maintain partnerships with payment processors;
- the security of our platform and the protection of data on our platform;
- our plans for and ability to achieve positive returns on investments, including investment in research and development, sales and marketing, the development of our customer and consumer support teams and our data center infrastructure, and our ability to effectively manage our growth and associated investments;
- our ability to successfully identify, acquire and integrate companies (including FitMetrix, Inc. (“FitMetrix”), and Booker Software, Inc. (“Booker”)) and assets in a manner that generates positive returns;
- our expectations relating to our acquisitions of FitMetrix and Booker;
- the sufficiency of our cash and cash equivalents on hand, short-term investments, cash generated from operations or equity and/or debt financing activities to meet requirements for working capital and capital expenditures;
- the effects of seasonal trends on our operating results;
- our ability to attract and retain senior management, qualified employees and key personnel;
- our ability to successfully enter new markets and manage our international expansion; and
- our ability to maintain, protect and enhance our intellectual property and not infringe upon others’ intellectual property.

We caution you that the foregoing list may not contain all of the forward-looking statements made in this Quarterly Report on Form 10-Q. You should not rely upon forward-looking statements as predictions of future events. The outcomes of the events described in these forward-looking statements are subject to substantial risks, uncertainties and other factors described in Part II, Item 1A– “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. We cannot assure you that the results,

events and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events or circumstances could differ materially from those described in the forward-looking statements. The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make.

Investors and others should note that we announce material financial information to our investors using our investor relations website (<http://investors.mindbodyonline.com/investor-overview>), SEC filings, press releases, public conference calls and webcasts. We use these channels, as well as social media, to communicate with our members and the public about our company, our services and other issues. Therefore, we encourage investors, the media, and others interested in our company to review the information we provide on the channels listed above.

GLOSSARY

To assist you in reading this Quarterly Report on Form 10-Q, we have provided definitions of some of the terms and acronyms that we use:

“Active consumer” – As of a given date, the estimated number of unique clients of our customers’ services who have used our platform to transact with our customers during the two years ending on such date. While we do not directly monetize consumers of our subscribers’ services, we believe that growth in the number of active consumers on our platform also contributes to our subscriber growth. For a discussion of risks related to our calculation of active consumers, see the section titled “Risk Factors – Real or perceived inaccuracies in our key, user and other metrics may harm our reputation and negatively affect our business.”

“API” – Application programming interface.

“app” – Application.

“ARPS” – Average monthly revenue per subscriber.

“Client” – A consumer who has chosen to purchase services from a customer's business.

“Consumer” – Any person who may purchase fitness, beauty or wellness services.

“High Value Subscriber” – Any customer on our platform, including FitMetrix customers and Booker customers, exclusive of those customers on the Solo software level.

“Subscriber” or “Customer” – Unique physical locations or individual practitioners who have active subscriptions to our services, including MINDBODY, Booker or FitMetrix, as of the end of the period. Subscribers or customers do not include locations or practitioners who only use Frederick (our marketing automation software).

“The app” or “The MINDBODY app” – The MINDBODY app, our consumer-facing mobile application.

“Wellness Practitioner” or “Practitioner” – Generally, staff members, instructors, trainers and stylists, and specifically where discussed as a number, those staff members, instructors, trainers and stylists with one or more bookings on our platform in the last month of the applicable period.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

MINDBODY, INC.

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

(Unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$154,074	\$232,019
Short-term investments	171,016	—
Accounts receivable	12,639	10,753
Deferred commissions, current portion	2,645	—
Prepaid expenses and other current assets	8,948	5,776
Total current assets	349,322	248,548
Property and equipment, net	33,001	32,871
Deferred commissions, non-current portion	6,926	—
Intangible assets, net	69,272	7,377
Goodwill	111,468	11,583
Other non-current assets	1,303	934
TOTAL ASSETS	\$571,292	\$301,313
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$11,327	\$7,448
Accrued expenses and other liabilities	16,595	13,099
Deferred revenue, current portion	7,962	6,318
Other current liabilities	1,093	1,828
Total current liabilities	36,977	28,693
Convertible senior notes, net	234,946	—
Deferred revenue, non-current portion	1,339	3,201
Deferred rent, non-current portion	2,239	1,966
Financing obligation on leases, non-current portion	14,479	14,932
Other non-current liabilities	450	585
Total liabilities	290,430	49,377
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Class A common stock, par value of \$0.000004 per share; 1,000,000,000 shares authorized, 45,361,076 shares issued and outstanding as of September 30, 2018; 1,000,000,000 shares authorized, 43,041,405 shares issued and outstanding as of December 31, 2017	1	1
Class B common stock, par value of \$0.000004 per share; 100,000,000 shares authorized, 2,551,823 shares issued and outstanding as of September 30, 2018; 100,000,000 shares authorized, 3,901,966 shares issued and outstanding as of December 31, 2017	—	—
Additional paid-in capital	515,334	454,196
Accumulated other comprehensive loss	(343)	(108)
Accumulated deficit	(234,130)	(202,153)
Total stockholders' equity	280,862	251,936

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$571,292	\$301,313
--	-----------	-----------

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

MINDBODY, INC.
Condensed Consolidated Statements of Operations
(in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue	\$63,782	\$46,612	\$179,216	\$132,933
Cost of revenue	20,189	13,123	55,027	37,880
Gross profit	43,593	33,489	124,189	95,053
Operating expenses:				
Sales and marketing	25,959	18,514	68,845	52,210
Research and development	18,960	8,976	48,295	26,426
General and administrative	13,175	9,763	41,913	27,807
Total operating expenses	58,094	37,253	159,053	106,443
Loss from operations	(14,501)	(3,764)	(34,864)	(11,390)
Interest income	1,482	485	2,581	808
Interest expense	(4,040)	(313)	(5,374)	(933)
Other income (expense), net	(9)	45	27	(56)
Loss before provision for income taxes	(17,068)	(3,547)	(37,630)	(11,571)
Income tax provision (benefit)	169	83	(1,811)	343
Net loss	(17,237)	(3,630)	(35,819)	(11,914)
Net loss per share, basic and diluted	\$(0.36)	\$(0.08)	\$(0.75)	\$(0.27)
Weighted-average shares used to compute net loss per share, basic and diluted	47,808	46,460	47,491	43,475

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

MINDBODY, INC.

Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net loss	\$(17,237)	\$(3,630)	\$(35,819)	\$(11,914)
Other comprehensive gain, net of taxes:				
Net change in cumulative translation adjustment	(14)	22	(136)	165
Unrealized loss on available-for-sale securities	(99)	—	(99)	—
Comprehensive loss	\$(17,350)	\$(3,608)	\$(36,054)	\$(11,749)

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

MINDBODY, INC.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$(35,819)	\$(11,914)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Stock-based compensation expense	19,840	9,925
Depreciation and amortization	13,544	6,736
Amortization of contract acquisition costs	1,009	—
Amortization of debt discount and transaction costs	4,125	—
Partial release of valuation allowance	(2,133))
Accretion of discounts on investments	(199))
Other	(5)	) 17
Changes in operating assets and liabilities net of effects of acquisitions:		
Accounts receivable	306	(839)
Deferred commissions	(9,657))
Prepaid expenses and other assets	(2,406)	) (1,897)
Accounts payable	(1,077)	) 1,661
Accrued expenses and other liabilities	3,224	265
Deferred revenue	1,375	1,152
Deferred rent	362	418
Net cash provided by (used in) operating activities	(7,511)	) 5,524
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of short-term investments	(171,102))
Purchase of property and equipment	(5,927)	) (4,781)
Additions to internally developed software	(1,366)	) (1,011)
Acquisition of business, net of cash acquired	(151,765)	) (1,450)
Net cash used in investing activities	(330,160)	) (7,242)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of convertible senior notes, net of initial purchasers' discounts and transaction costs	301,848	—
Purchase of capped calls related to issuance of convertible senior notes	(36,422))
Net proceeds from follow-on public offering	—	134,277
Proceeds from exercise of equity awards	6,182	5,619
Proceeds from employee stock purchase plan	4,261	3,238
Payment related to shares withheld for taxes	(4,391)	) (1,563)
Repayment of Booker long-term debt	(10,008))
Repayment on financing and capital lease obligations	(384)	) (321)
Payment of financing obligations related to Lymber and HealCode acquisitions	(1,250)	) (250)
Other	—	) (33)
Net cash provided by financing activities	259,836	140,967
Effect of exchange rate changes on cash and cash equivalents	(110)	) 199
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(77,945)	) 139,448
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	232,019	85,864

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

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$154,074	\$225,312
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for income taxes	\$180	\$212
Cash paid for interest	899	934
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Earnout in business combination deemed part of total purchase consideration	\$—	\$5,142
Unpaid equipment purchases	1,545	1,664
Acquisition consideration held back to satisfy potential indemnification claims	—	500
Unpaid follow-on public offering costs	—	11
Debt issuance costs included in accounts payable and accrued expenses and other current liabilities	120	—
Fair value of stock awards assumed in connection with Booker acquisition	498	—
The accompanying notes are an integral part of these condensed consolidated financial statements.		

MINDBODY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business

MINDBODY, Inc. (“MINDBODY” or the “Company”) was incorporated in California in 2004 and reincorporated in Delaware in March 2015. MINDBODY is headquartered in San Luis Obispo, California and has operations in the United States, the United Kingdom, and Australia.

MINDBODY and its wholly-owned subsidiaries (collectively, the “Company”, “we”, “us” or “our”) is a provider of cloud-based business management software for the fitness, beauty and wellness services industries and a rapidly growing consumer brand. Its integrated software and payments platform helps business owners in the fitness, beauty and wellness services industries run, market and build their businesses. MINDBODY enables the consumers to evaluate, engage, and transact with local businesses in its marketplace.

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements are presented in accordance with United States generally accepted accounting principles (“GAAP”), which include the accounts of MINDBODY and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP, and follow the requirements of the Securities and Exchange Commission (“SEC”) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted. These financial statements have been prepared on the same basis as the Company’s annual financial statements and, in the opinion of management, reflect all adjustments consisting only of normal recurring adjustments that are necessary for a fair statement of the Company’s financial information. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2018. The year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted under the rules and regulations of the SEC.

These condensed consolidated financial statements and related financial information should be read in conjunction with the audited consolidated financial statements and related notes thereto for the year ended December 31, 2017 included in the Annual Report on Form 10-K (“Annual Report”), which was filed with the SEC on March 1, 2018.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the capitalization and estimated useful life of the Company’s internally developed software, useful lives of property and equipment, the period of benefit that deferred commissions are amortized over, the determination of fair value of stock awards issued and forfeiture rates, a valuation allowance for deferred tax assets, contingencies, fair value of the liability and equity components of the Notes and the purchase price allocation of acquired businesses. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances. Changes in facts or circumstances may cause the Company to change its assumptions and estimates in future periods, and it is possible that actual results could differ from current or future estimates.

Concentration of Credit Risk

As of September 30, 2018 and December 31, 2017, one trade receivable represented 9% and 17% of the accounts receivable balance, respectively. No single customer, API partner, or technology partner represented over 10% of revenue for any of the periods presented in the condensed consolidated statements of operations.

Summary of Significant Accounting Policies

There have been no material changes in the Company's significant accounting policies as compared to those described in the Company's Annual Report, other than the adoption of the new guidance on revenue from contracts with customers described below under the heading Recently Adopted Accounting Pronouncements and Note 2 – "Revenue Recognition," new policies related to the Company's recent issuance of convertible senior notes and capped calls, and new policies related to the Company's purchases of short-term investments.

Convertible Senior Notes and Capped Call Transactions

The Company accounts for the issued Notes as separate liability and equity components. The Company determined the carrying amount of the liability component based on the fair value of a similar debt instrument excluding the embedded conversion option. The carrying amount of the equity component representing the conversion option was calculated by deducting the carrying value of the liability component from the principal amount of the Notes as a whole. This difference represents a debt discount that is amortized to interest expense over the term of the Notes using the effective interest rate method. The equity component of the Notes is included in stockholders' equity and is not remeasured as long as it continues to meet the conditions for equity classification. The Company allocated transaction costs related to the issuance of the Notes to the liability and equity components using the same proportions as the initial carrying value of the Notes. Transaction costs attributable to the liability component are being amortized to interest expense using the effective interest method over the respective term of the Notes, and transaction costs attributable to the equity components were netted with the equity component of the Notes in stockholders' equity. In connection with the issuance of the Notes, the Company entered into capped call transactions with certain counterparties affiliated with the initial purchasers and others. The Company accounts for the cost of the capped calls as a reduction to additional paid-in capital.

Short-term Investments

The Company classifies its investments in marketable securities as available-for-sale and presents them within current assets since these investments are available to fund current operations. Investments with an original maturity of three months or less at the date of purchase are considered cash equivalents. Investments with an original maturity of greater than three months and equal to or less than one year are classified as short-term investments. The Company does not currently hold any investments with maturities greater than one year.

The Company carries its available-for-sale investments at fair value. Fair value is calculated based on publicly available market information or other estimates determined by management. Unrealized gains and losses are reported as a component of other comprehensive loss. Realized gains and losses are determined based on the specific identification method and are reflected in its Consolidated Statements of Operations.

There were no realized gains or losses on available-for-sale investments for the three and nine months ended September 30, 2018. The Company regularly reviews its investment portfolio to identify and evaluate investments that have indicators of possible impairment. Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. Factors considered in determining whether a loss is other-than-temporary include, but are not limited to: the length of time and extent a security's fair value has been below its cost, the financial condition and near-term prospects of the investee, the credit quality of the security's issuer, likelihood of recovery and the Company's intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in value. For its debt instruments, the Company evaluates whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded to other income (expense) and a new cost basis in the investment is established.

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09) ("Topic 606"). Topic 606 requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. It also states that an entity should recognize as an asset the incremental costs of obtaining a contract that the entity expects to recover and amortize that cost over a period consistent with the period over which the transfer to the customer of the underlying good or services occurs. Topic 606 requires more detailed disclosures to enable users of financial statements to

understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

10

The Company adopted Topic 606 effective January 1, 2018 using the modified retrospective method to apply this guidance to all open contracts at the date of initial application, which resulted in an adjustment to accumulated deficit for the cumulative effect of applying this guidance.

Under Topic 606, incremental costs of obtaining a contract are recorded as an asset and recognized as an operating expense over the period that the Company expects to recover the costs, which is approximately four years.

The most significant impact of Topic 606 on revenue to the Company relates to the timing of revenue recognition for one of its payment contracts. Under Topic 606, the Company estimates the transaction price, including variable consideration, at the commencement of the contract and recognizes revenue over the contract term, rather than when fees become fixed or determinable.

The cumulative effect of changes related to the adoption of Topic 606 are reflected in the opening balance of accumulated deficit is shown below:

	As Reported	Revenue Standard Adjustments			As Adjusted
	December 31, 2017	Payments Contract	Product and Other	Cost to obtain a Contract	January 1, 2018
ASSETS					
Prepaid expenses and other current assets	\$5,612	\$—	\$ 38	\$ —	\$5,650
Other non-current assets	934	—	33	—	967
Deferred commissions, current portion	—	—	—	224	224
Deferred commissions, non-current portion	—	—	—	677	677
LIABILITIES					
Deferred revenue, current portion	\$6,318	\$(958)	\$ —	\$ —	\$5,360
Deferred revenue, non-current portion	3,201	(1,912)	—	—	1,289
STOCKHOLDERS' EQUITY					
Accumulated deficit	\$(202,153)	\$2,869	\$ 72	\$ 900	\$(198,312)

See Note 2 – “Revenue Recognition,” for additional accounting policy and transition disclosures.

In May 2017, the FASB issued authoritative guidance related to employee Share-Based Payments Transactions. The new guidance clarifies which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Specifically, an entity should not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments in this guidance are effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company adopted the guidance on the effective date. The new guidance did not have and is not expected to have a material impact on the Company’s consolidated financial statements.

In January 2017, the FASB issued authoritative guidance related to Clarifying the Definition of a Business. The new guidance clarifies whether transactions should be accounted for as acquisitions of assets or businesses. To be considered a business, the assets in the transaction need to include an input and a substantive process that together significantly contribute to the ability to create outputs. Prior to the adoption of this new guidance, an acquisition or disposition would be considered a business if there were inputs, as well as processes that when applied to those inputs had the ability to create outputs. The standard is effective for fiscal years beginning after December 15, 2017, and

interim periods within those fiscal years. The Company adopted the guidance on the effective date noting there was no impact on its consolidated financial statements or the acquisitions of FitMetrix and Booker.

In January 2017, the FASB issued authoritative guidance related to Simplifying the Test for Goodwill Impairment. The new guidance simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test. The standard is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and should be applied

on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company early adopted the guidance effective on January 1, 2018. The authoritative guidance will be applied prospectively and used when the annual impairment test is performed in the current year. The Company does not expect that the adoption of this guidance will have a significant impact on its consolidated financial statements.

In August 2016, the FASB issued authoritative guidance related to the Classification of Certain Cash Receipts and Cash Payments. The new guidance standardizes cash flow statement classification of certain transactions, including cash payments for debt prepayment or extinguishment, proceeds from insurance claim settlements, and distributions received from equity method investments. The new guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The amendments in this update should be applied using a retrospective transition method to each period presented. If impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company adopted the guidance on the effective date noting the adoption of the new guidance did not have and is not expected to have a material impact on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements

In August 2018, the FASB issued authoritative guidance on customer's accounting for implementation costs incurred in a cloud computing arrangement that is a service contract. The guidance aligns the requirements for capitalizing implementation costs in a cloud computing arrangement service contract with the requirements for capitalizing implementation costs incurred for an internal-use software license. The new guidance is effective for the Company beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted. The Company is evaluating the impact of the new standard on its consolidated financial statements.

In August 2018, the FASB issued authoritative guidance on fair value measurement. The guidance eliminates such disclosures as the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy. The guidance adds new disclosure requirements for Level 3 measurements. The new guidance is effective for the Company beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted. The Company is evaluating the impact of the new standard on its consolidated financial statements.

In June 2018, the FASB issued authoritative guidance intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share-based compensation. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2018. The Company does not expect that the adoption of this guidance will have a significant impact on its consolidated financial statements.

In March 2018, the FASB issued authoritative guidance intended to state the income tax accounting implications of the Tax Cuts and Jobs Act (the "New Tax Act"), which clarifies the measurement period time frame, changes in subsequent reporting periods and reporting requirements as a result of the New Tax Act. The guidance allows disclosure that some or all of the income tax effects from the New Tax Act are incomplete by the due date of the financial statements and requests entities provide a reasonable estimate if possible. The Company has accounted for the tax effects of the New Tax Act under the guidance on a provisional basis. The Company's accounting for certain income tax effects is incomplete, but it has determined reasonable estimates for those effects and has recorded provisional amounts in its consolidated financial statements as of September 30, 2018 and December 31, 2017.

In January 2018, the FASB issued authoritative guidance related to income statement-reporting for comprehensive income. The standard will permit entities to reclassify tax effects stranded in accumulated other comprehensive income as a result of U.S. tax reform to retained earnings. The new guidance is effective for the Company beginning after December 15, 2018, and interim periods within those fiscal years. The effects of this standard on the Company's financial position, results of operations and cash flows are not expected to be material.

In February 2016, the FASB issued authoritative guidance intended to improve financial reporting about leasing transactions. The new guidance requires entities to recognize assets and liabilities for leases with lease terms of more than 12 months. The new guidance also requires qualitative and quantitative disclosures regarding the amount, timing, and uncertainty of cash flows arising from leases. The Company expects to adopt this guidance effective January 1, 2019. In addition, the FASB issued ASU 2018-11, Leases Targeted Improvements, which provides an additional transition method that allows entities to apply the new leases standard at adoption date and recognize a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. The Company has elected this new transition method when it adopts this guidance on January 1, 2019. The Company is evaluating the impact of the new standard on its consolidated financial statements and anticipates recording certain operating leases on the balance sheet upon adoption.

2. REVENUE RECOGNITION

The Company adopted Topic 606 effective January 1, 2018 using the modified retrospective method applying this guidance to all open contracts at the date of initial application, which resulted in an adjustment to accumulated deficit for the cumulative effect of applying this guidance.

The Company generates revenue primarily from providing an integrated cloud-based business management software and payments platform for the fitness, beauty and wellness services industries and, to a lesser extent, products.

The Company determines revenue recognition through the following steps:

- i. Identification of the contract, or contracts, with a customer
- ii. Identification of the performance obligations in the contract
- iii. Determination of the transaction price
- iv. Allocation of the transaction price to the performance obligations in the contract
- v. Recognition of revenue when, or as, the Company satisfies a performance obligation

The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Components of Revenue

The following is a description of principal activities from which the Company generates revenue. As part of the accounting for these arrangements, the Company must develop assumptions that require judgment to determine the stand-alone selling price for each performance obligation identified in the contract. Stand-alone selling prices are determined based on the prices at which the Company separately sells its services or goods.

Subscription and Services. Subscription and services revenue is generated primarily from sales of subscriptions to the Company's cloud-based business management software for the fitness, beauty and wellness services industries. The majority of subscription fees are prepaid by customers on a monthly basis. The Company has concluded that each promised service is delivered concurrently with all other promised services over the contract term and, as such, has concluded that these promises are a single performance obligation that includes a series of distinct services that have the same pattern of transfer to the customer. The use of the cloud-based bundle and premium services is a stand-ready obligation to provide access to the Company's cloud-based offering and related services over the contract term. Customers simultaneously receive and consume the benefit from the Company's stand-ready obligation to perform these services. For subscription and service contracts, the period of time over which the Company is performing is commensurate with the contract term because that is the period during which the Company has an obligation to provide the service. The performance obligation is recognized on a time elapsed basis, by month for which the services are provided, as the Company transfers control evenly over the contractual period.

Additionally, the Company's customers can choose to enter into a separate contract with its technology partners to purchase additional services for which the technology partner is the principal. The Company satisfies its stand-ready performance obligation by providing technology partners access to its platform for usage-based contracts. The transaction price includes variable consideration which is allocated to the series of distinct services the Company is providing each day. The variability is resolved as the performance of distinct services are satisfied and any remaining variability is allocated to unsatisfied performance obligations.

The Company also earns revenue from providing API partners access to customers sites, consumer bookings, and data query, through its platform. The Company satisfies its stand-ready performance obligation by providing access to its API and by processing transactions for usage-based contracts. The transaction price is calculated based on the number of transactions processed through its platform. Usage-based fees are deemed to be variable consideration that meet the

“as invoiced” practical expedient as they are specific to the month that the usage occurs.

Payments. The Company earns payments revenue from revenue share arrangements with third-party payment processors on transactions between its customers who utilize the Company’s payments platform and their consumers. These payment transactions are generally related to purchases of classes, memberships, appointments, goods or services through a customer’s website, at its business location, and through the MINDBODY app. These transaction fees are recorded as revenue on a net basis when the payment transactions occur. The Company satisfies its performance obligation by providing access to its platform and processing transactions for payment-related services. Payment fees are variable consideration that meet the “as invoiced” practical expedient as they are specific to the month that the usage occurs.

Products and Other. The Company offers various point-of-sale system products, heart-rate monitors, and physical gift cards to its customers. The Company recognizes revenue when the customer obtains control of the Company's product, which occurs at a point in time, typically upon delivery.

Disaggregation of Revenue

The following table provides information about disaggregated revenue by primary geographical market (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Primary geographical markets				
United States	\$52,017	\$37,284	\$145,675	\$107,295
Other	11,765	9,328	33,541	25,638
Total revenue	\$63,782	\$46,612	\$179,216	\$132,933

The following table provides information about disaggregated revenue by major product line (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Primary product lines				
Subscription and services	\$40,792	\$28,283	\$112,075	\$79,228
Payments	22,037	17,786	64,532	52,155
Product and other	953	543	2,609	1,550
Total revenue	\$63,782	\$46,612	\$179,216	\$132,933

Subscription and service revenue and payments revenue is transferred over time and products and other revenue is transferred at a point in time.

Contract Balances

The following table provides information about contract assets and deferred revenue from contracts with customers (in thousands):

	Contract Assets		Deferred Revenue	
	Prepaid expenses and other current assets	Other non-current assets	Current	Non-Current
January 1, 2018	\$ 38	\$ 33	\$ 5,360	\$ 1,289
September 30, 2018	142	64	7,962	1,339

The Company receives payments from customers based upon contractual billing schedules. Accounts receivable are recorded when the right to consideration becomes unconditional. Contract assets includes amounts related to the Company's contractual right to consideration for completed performance obligations not yet invoiced. Deferred revenues include payments received or invoiced in advance of performance under the contract and are realized with

the associated revenue recognized under the contract. The Company had no asset impairment charges related to contract assets in the period. Deferred revenue at September 30, 2018 includes current and non-current deferred revenue related to the acquisition of Booker of \$1,043,000 and \$107,000, respectively.

Movement between contract assets and receivables was not significant during the three and nine months ended September 30, 2018.

Deferred Commissions Costs (Contract Acquisition Costs)

Contract acquisition costs, which primarily consists of sales commissions paid, are considered incremental and recoverable costs of obtaining a contract with a customer. Sales commissions for initial contracts are deferred and then amortized on a straight-line basis over a period of benefit that the Company has determined to be four years. The Company determined the period of benefit by taking into consideration its customer life and its technology useful life. Amortization expense is included in sales and marketing expenses on the condensed consolidated statements of operations.

Contract acquisition costs that were capitalized and deferred for the three and nine months ended September 30, 2018 were \$3,793,000 and \$9,750,000, respectively. Amortization expenses for contract acquisition costs for the three and nine months ended September 30, 2018 were \$545,000 and \$1,009,000, respectively. There was no impairment loss in relation to costs capitalized.

Practical Expedients and Exemptions

The Company has elected the following additional practical expedients in applying Topic 606:

Portfolio Approach: The Company is utilizing the portfolio approach practical expedient for its contract portfolios, e.g., subscription and services. The Company accounts for its contracts within each portfolio as a collective group rather than individual contracts. Based on the Company's history with these portfolios and the similar nature and characteristics of the customers within each portfolio, it has concluded that the financial statement effects are not materially different than if accounting for revenue on a contract-by-contract basis.

Sales Tax Exclusion from the Transaction Price: The Company excludes from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the Company from its customers.

Transaction Price Allocated to the Remaining Performance Obligations

The following table includes revenue expected to be recognized for performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period (in thousands):

	2018 (Remaining three months)	2019	2020	Thereafter
Payments revenue \$	516	\$2,062	\$2,062	\$ 1,547

The transaction price for all unsatisfied performance obligations related to subscription and service revenue is not shown in the table above as it is included in deferred revenue - current on the condensed consolidated balance sheet. Revenue recognized during the three and nine months ended September 30, 2018 from performance obligations satisfied or partially satisfied in previous periods was not significant.

Comparative GAAP Financials

The adoption of the new standard has the following impact to the Company's condensed consolidated statements of operations (in thousands):

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

Three Months Ended September 30,
2018

	As Reported	Balances without adoption of Topic 606	Effect of Change Higher/(Lower)
Revenues			
Subscription and services	\$40,792	\$40,792	\$ —
Payments	22,037	22,120	(83)
Product and Other	953	953	—
Operating Expenses and Net Loss			
Sales and marketing	25,959	29,206	(3,247)
Net loss	(17,237)	(20,447)	3,210

Nine Months Ended September 30,
2018

	As Reported	Balances without adoption of Topic 606	Effect of Change Higher/(Lower)
Revenues			
Subscription and services	\$112,075	\$112,075	\$ —
Payments	64,532	64,673	(141)
Product and Other	2,609	2,609	—
Operating Expenses and Net Loss			
Sales and marketing	68,845	77,581	(8,736)
Net loss	(35,819)	(44,548)	8,729

The adoption of Topic 606 has the following impact to the Company's Condensed Consolidated Balance Sheet (in thousands):

	September 30, 2018	Balances without adoption of Topic 606	Effect of Change Higher/(Lower)
ASSETS			
Prepaid expenses and other current assets	\$8,948	\$8,806	\$ 142
Other non-current assets	1,303	1,239	64
Deferred commissions, current portion	2,645	—	2,645
Deferred commissions, non-current portion	6,926	—	6,926
LIABILITIES			
Deferred revenue, current portion	\$7,962	\$8,871	\$ (909)

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

Deferred revenue, non-current portion	1,339	3,158	(1,819)
---------------------------------------	-------	-------	--------	---

STOCKHOLDERS' EQUITY

Accumulated deficit	\$(234,130)	\$(246,635)	\$ (12,505)
---------------------	-------------	-------------	------------	---

16

3. FAIR VALUE MEASUREMENTS

The accounting guidance for fair value measurements provides a framework for measuring fair value on either a recurring or nonrecurring basis, whereby the inputs used in our valuation techniques are assigned a hierarchical level. The following are the three levels of inputs to measure fair value:

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs that reflect quoted prices for identical assets or liabilities in less active markets; quoted prices for similar assets or liabilities in active markets; benchmark yields, reported trades, broker/dealer quotes, inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs that reflect our own assumptions incorporated in valuation techniques used to measure fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

The Company considers an active market to be one in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis, and consider an inactive market to be one in which there are infrequent or few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers. Where appropriate, the Company's own or the counterparty's non-performance risk is considered in measuring the fair values of assets.

Available-for-sale investments within cash equivalents and investments consist of the following (in thousands):

	September 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Money market funds	\$ 138,927	\$ —	—	\$ 138,927
U.S. Government bonds	74,255	—	(74)	74,181
Commercial paper	58,705	—	—	58,705
Corporate bonds	23,301	—	(22)	23,279
Treasury bills	14,854	—	(3)	14,851
Total	\$ 310,042	\$ —	—\$ (99)	\$ 309,943

Unrealized losses related to these investments are due to interest rate fluctuations as opposed to credit quality. In addition, the Company does not intend to sell, and it is not more likely than not that the Company would be required to sell, these investments before recovery of their cost basis. As a result, there is no other-than-temporary impairment for these investments as of September 30, 2018.

The following table presents the fair value of the Company's financial instruments by level within the fair value hierarchy (in thousands):

	September 30, 2018			Total
	Level 1	Level 2	Level 3	
Available-for-sale investments included in cash equivalents:				
Money market funds	\$138,927	\$—	\$—	\$138,927
Available-for-sale investments included in short-term investments:				
U.S. Government bonds	\$—	\$74,181	\$—	\$74,181
Commercial paper	—	58,705	—	58,705
Corporate bonds	—	23,279	—	23,279
Treasury bills	14,851	—	—	14,851
Total	\$14,851	\$156,165	\$—	\$171,016
Equity:				
Acquisition-related contingent consideration ⁽¹⁾	\$—	\$—	\$5,143	\$5,143

All available-for-sale securities have been classified as current, based on management's intent and ability to use the funds in current operations.

	December 31, 2017			Total
	Level 1	Level 2	Level 3	
Available-for-sale investments included in cash equivalents:				
Money market funds	\$224,165	\$—	\$—	\$224,165
Equity:				
Acquisition-related contingent consideration ⁽¹⁾	\$—	\$—	-\$5,143	\$5,143

The contingent consideration related to the acquisition of Lymber Wellness, Inc. (“Lymber”) (see Note 5 - “Business Combinations”) is recorded as equity and is not subject to remeasurement. Fair value was based on significant inputs not observable in the market, which represents a Level 3 measurement within the fair value hierarchy. The (1) Company determined the fair value of the contingent consideration by discounting payments that are calculated based on Lymber’s projected future gross profit scenarios using the Monte Carlo simulation. The significant inputs used in the fair value measurement of contingent consideration are the timing and amount of gross profit in the respective periods (see Note 5 – “Business Combinations”) and the discount rate.

Convertible Senior Notes

The Company carries the Notes at face value less unamortized debt discount and issuance costs on its consolidated balance sheet and presents the fair value for disclosure purposes only. The estimated fair value of the Notes as of September 30, 2018 was determined to be \$319,256,000. The Company classifies the Notes as Level 2 financial instruments and calculates the fair value based on the quoted bid price of comparable instruments in an over-the-counter market on the last trading day of the reporting period. For further information on the Notes see Note 7 – “Debt”.

There were no transfers of financial instruments between the three levels of the fair value hierarchy during the nine months ended September 30, 2018. As of September 30, 2018 and December 31, 2017, the Company did not have any assets or liabilities that were required to be measured at fair value on a nonrecurring basis.

4. BALANCE SHEET COMPONENTS

Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Prepaid expenses	\$ 7,789	\$ 5,342
Other current assets ⁽¹⁾	1,159	434
Prepaid expenses and other current assets	\$ 8,948	\$ 5,776

(1) Other receivables, which used to be presented with accounts receivable, is now presented with other current assets. Certain immaterial reclassifications have been made to the prior year amounts to conform with current year presentation.

Property and Equipment, net

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

	September 30, 2018	December 31, 2017
Computer equipment	\$ 24,122	\$ 20,671
Leasehold improvements	12,761	11,386
Office equipment	3,714	2,702
Software licenses	6,336	5,378
Building, leased	16,438	16,438
Property and equipment, gross	63,371	56,575
Less: accumulated depreciation and amortization	(30,370)	(23,704)
Property and equipment, net	\$ 33,001	\$ 32,871

Depreciation of property and equipment was \$2,196,000 and \$1,921,000 for the three months ended September 30, 2018 and 2017, respectively. Depreciation of property and equipment was \$6,355,000 and \$5,725,000 for the nine months ended September 30, 2018 and 2017, respectively.

Accrued Expenses and Other Liabilities

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

	September 30, 2018	December 31, 2017
Accrued payroll	\$ 10,303	\$ 7,591
Accrued vacation	3,497	2,400
Employee stock purchase plan contributions	824	1,548
Other liabilities	1,971	1,560
Total accrued expenses and other liabilities	\$ 16,595	\$ 13,099

5. BUSINESS COMBINATION

Booker

On April 2, 2018, the Company completed the acquisition of Booker, a privately-held company. Booker is a leading cloud-based business management platform for salons and spas, and is the provider of Frederick, an automated marketing software for wellness businesses. The acquisition of Booker added additional high-value salons and spas to the Company's marketplace, combining MINDBODY's leadership in boutique fitness studios and its vast consumer network with Booker's leadership in high

value salons and spas. The Company expects that the combination of the two businesses will deliver more value to its customers by connecting them to larger consumer audiences, helping them grow their businesses.

The acquisition of Booker was accounted for in accordance with the acquisition method of accounting for business combinations with MINDBODY as the accounting acquirer. Under the acquisition method of accounting, the total purchase consideration is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values.

The total purchase consideration of \$140,429,000 consisted of \$139,931,000 in cash, subject to net-working capital adjustments, and approximately 73,900 common stock awards assumed with an estimated fair value of \$498,000. In addition, the Company simultaneously assumed and subsequently paid off approximately \$10,008,000 of long-term debt and \$3,047,000 of assumed fees associated with the transaction. The purchase price was allocated as follows: \$58,260,000 to identifiable intangible assets acquired and \$9,051,000 in net liabilities acquired, with the excess \$91,220,000 of the purchase price over the fair value of net assets acquired recorded as goodwill. Goodwill is primarily attributable to expanded market opportunities from selling and integrating Booker and Frederick's technology solution with the Company's other offerings and the associated assembled workforce acquired. Goodwill is not expected to be deductible for U.S. federal income tax purposes.

The fair value of the acquired intangible assets are amortized on straight-line basis over the remaining useful life, which approximates the expected use of these assets. The estimated useful lives and fair values of the identifiable intangible assets are as follows (in thousands):

	Amount	Estimated Useful Life (in years)
Trade names	\$3,720	7
Customer relationships	48,400	3 to 8
Developed technology	5,740	5
Covenants-not-to-compete	400	2
Total intangible assets acquired	\$58,260	

The results of operations of Booker are included in the Company's consolidated statements of operations, commencing on the acquisition date, April 2, 2018. In the three and nine months ended September 30, 2018, the Company's condensed consolidated statement of operations includes revenues of \$7,004,000 and \$13,860,000, respectively, and net loss of \$4,330,000 and \$8,780,000, respectively, associated with the operations of Booker.

Acquisition-related expenses, including legal and accounting fees and other external costs directly related to the acquisition, were expensed as incurred. Acquisition-related expenses of \$579,000 and \$4,867,000 for the three and nine months ended September 30, 2018, respectively, are included in general and administrative expense in our condensed consolidated statement of operations.

The following unaudited pro forma information has been prepared for illustrative purposes only and assumes the acquisition occurred on January 1, 2017 and includes pro forma adjustments related to the amortization of acquired intangible assets, share-based compensation expense and incremental contract acquisitions costs (commissions) to conform with the Company's presentation of Topic 606. The unaudited pro forma results have been prepared based on estimates and assumptions, which the Company believes are reasonable, however, they are not necessarily indicative of the consolidated results of operations had the acquisition occurred on January 1, 2017, or of future results of operations (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue ⁽¹⁾	\$63,782	\$53,242	\$185,884	\$154,404

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

Net loss attributable to common shareholders	(17,237)	(7,110)	(40,963)	(21,529)
Net loss per share attributable to common shareholders - basic and diluted.	\$(0.36)	\$(0.15)	\$(0.86)	\$(0.50)

20

(1) The following table shows adjusted unaudited pro forma information excluding the revenue from one terminated non-recurring transition services arrangement that was not related to its core product offering on an ongoing basis. The Company believes that this adjustment provides a useful basis for understanding the performance of its business as the terminated contract is not indicative of its ongoing business (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue	\$63,782	\$53,242	\$185,884	\$154,404
Less: revenue from Booker terminated contract	—	—	—	2,875
Revenue excluding Booker terminated contract	\$63,782	\$53,242	\$185,884	\$151,529

FitMetrix

On February 19, 2018, the Company completed the acquisition of FitMetrix, a privately-held company. FitMetrix, a MINDBODY technology partner at the time of acquisition, specializes in innovative performance tracking integrations with fitness studio equipment and wearables. The FitMetrix technology helps enable business owners to increase retention in group and personal training environments, and provides wellness seekers with an engaging, more interactive fitness experience.

The acquisition of FitMetrix was accounted for in accordance with the acquisition method of accounting for business combinations with MINDBODY as the accounting acquirer. Under the acquisition method of accounting, the total purchase consideration is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The purchase price of \$15,341,000, paid in cash, was allocated as follows: \$9,540,000 to identifiable intangible assets acquired, \$731,000 in net liabilities acquired and \$2,133,000 to net deferred tax liabilities, with the excess \$8,665,000 of the purchase price over the fair value of net assets acquired recorded as goodwill. Goodwill is primarily attributable to expanded market opportunities from selling and integrating the FitMetrix technology solution with the Company's other offerings and the associated assembled workforce acquired and is not expected to be deductible for U.S. federal income tax purposes.

The acquisition provided the Company with acquired intangible assets representing trade names, customer relationships, and developed software/technology. The fair value of the acquired intangible assets is amortized on straight-line basis over the remaining useful life and is not expected to be deductible for tax purposes. As such, the Company recorded a net deferred tax liability which is comprised of deferred tax liabilities recognized in connection with the acquired intangible assets partially offset by deferred tax assets associated with acquired net operating loss carryforwards and credits.

The fair value of the acquired intangible assets are amortized on a straight-line basis over the remaining useful life, which approximates the expected use of these assets. The estimated useful lives and fair values of the identifiable intangible assets are as follows (in thousands):

	Amount	Estimated Useful Life (in years)
Trade names	\$ 1,800	10
Customer relationships	5,800	5
Developed technology	1,940	5
Total intangible assets acquired	\$ 9,540	

The results of FitMetrix are included in the Company's consolidated statements of operations since the acquisition date, including revenues and net loss, and were not material. Pro forma results of operations have not been presented because the acquisition was not material to the Company's results of operations.

Lymber

In March 2017, the Company completed the acquisition of substantially all of the assets of Lymber, a privately-held API partner that specializes in yield management solutions for class and appointment-based businesses. Lymber's technology enables business owners to set dynamic pricing parameters for class and appointment sessions. The

technology identifies open class and appointment inventory, and automatically adjusts session prices in real-time to match supply and demand.

The total purchase consideration for these assets was \$7,342,000, which included cash consideration of \$2,200,000, and contingent consideration with a fair value of approximately \$5,142,000, of which \$1,304,000 and \$3,838,000 are expected to be earned in 2018 and 2019, respectively, payable in Class A common stock. This consideration is contingent upon Lymber's product achieving certain levels of gross profit, measured annually, in 2018 and 2019, respectively, and the fair value of the equity classified contingent consideration was measured using a Monte Carlo simulation with various unobservable market data inputs, which are Level 3 measurements. The Company held back \$500,000 of the cash consideration to satisfy potential indemnification claims, which amount was included in other current liabilities. This hold-back amount was paid to Lymber in April 2018.

The acquisition of Lymber was accounted for in accordance with the acquisition method of accounting for business combinations with MINDBODY as the accounting acquirer. Acquisition-related costs incurred and expensed by the Company were immaterial and were included within general and administrative expenses on the consolidated statements of operations. Under the acquisition method of accounting, the total purchase consideration is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. Goodwill of \$2,544,000 was allocated to the Company's one operating segment and represents 35% of the total purchase consideration. Goodwill is primarily attributable to expanded market opportunities from selling and integrating Lymber's yield management solution with the Company's other offerings and the associated assembled workforce acquired. Goodwill is amortized over 15 years for tax purposes.

The fair value of the acquired intangible asset was determined based on the income approach and discounted cash flow/excess earnings method and is subject to amortization on a straight-line basis over its remaining useful life of five years.

The allocation of the purchase price consideration is as follows (in thousands):

	Amount
Intangible asset – developed software/technology	\$ 4,798
Goodwill	2,544
Fair value of total purchase consideration	\$ 7,342

The results of Lymber are included in the Company's consolidated statements of operations since the acquisition date, including revenues and net loss, and were not material. Pro forma results of operations have not been presented because the acquisition was not material to the Company's results of operations.

Contemporaneous to signing the purchase agreement, the stockholders of Lymber amended the existing company charter to effectively increase the distribution of ownership interest to existing stockholders who continued as employees with MINDBODY. The change in the ownership interest is viewed to have benefited MINDBODY, and as such, a portion of the contingent consideration discussed above is attributed to post-acquisition expense. The approximate fair value of this consideration is \$2,547,000, of which \$646,000 and \$1,901,000 relate to the 2018 and 2019 earnouts, respectively. This post-acquisition expense is being recorded as non-cash operating expense over the requisite service periods.

6. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company's goodwill balance is solely attributable to acquisitions. There have been no impairment charges recorded against goodwill.

The Company's intangible assets consisted of the following (in thousands except years):

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

September 30, 2018				
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Acquired technology	3 to 5	\$ 15,209	\$ (3,927)	\$ 11,282
Acquired trade names	7 to 10	5,520	(370)	5,150
Acquired customer relationships	2 to 8	54,620	(4,772)	49,848
Internally developed software	2 to 3	4,988	(2,297)	2,691
Covenants not-to-compete	2	400	(99)	301
Total intangible assets		\$ 80,737	\$ (11,465)	\$ 69,272
December 31, 2017				
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Acquired technology	3 to 5	\$ 7,529	\$ (2,104)	\$ 5,425
Acquired customer relationships	2	420	(420)	—
Internally developed software	2 to 3	3,703	(1,751)	1,952
Total intangible assets		\$ 11,652	\$ (4,275)	\$ 7,377

The Company capitalized software development costs of \$67,000 and \$774,000 for the three months ended September 30, 2018 and 2017, respectively. The Company capitalized software development costs of \$1,285,000 and \$1,011,000 for the nine months ended September 30, 2018 and 2017, respectively.

The Company has internally developed software in process, for development projects that qualify for capitalization, of \$67,000 and \$1,559,000 as of September 30, 2018 and December 31, 2017, respectively.

Amortization of intangible assets (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Amortization of acquired intangible assets	\$3,128	\$410	\$6,644	\$991
Amortization of internally developed software	265	6	545	20
Total amortization of intangible assets	\$3,393	\$416	\$7,189	\$1,011

The expected future annual amortization expense of intangible assets as of September 30, 2018 is presented below (in thousands):

Year Ending December 31,	
2018 (Remaining three months)	\$3,357
2019	13,322
2020	13,195
2021	10,641
2022	8,900
Thereafter	19,790
Total expected future amortization expense of intangible assets, excluding internally developed software in process.	\$69,205

7. DEBT

Credit Facility

On January 12, 2015, the Company entered into a loan agreement with Silicon Valley Bank for a secured revolving credit facility that allows the Company to borrow up to \$20,000,000 for working capital and general business requirements (the “senior secured credit facility”). The Company has not drawn down any amounts under the senior secured credit facility, which is secured by substantially all of the Company’s corporate assets.

On January 12, 2018, the Company amended the loan agreement with Silicon Valley Bank. Silicon Valley Bank extended the maturity date of the revolving line from January 12, 2018 to January 11, 2019 and included an accordion feature for the revolving line, such that the revolving line may, upon the Company’s request and subject to the satisfaction of certain conditions and approval by Silicon Valley Bank, be increased by an additional aggregate amount of up to \$20,000,000. Silicon Valley Bank also reduced the interest rate to the greater of the prime rate (5.25% as of September 30, 2018) or 4.5%. The credit facility is secured by substantially all of the Company’s corporate assets. On April 2, 2018, the Company entered into a consent and fourth loan agreement with Silicon Valley Bank, pursuant to which, among other amendments, Silicon Valley Bank consented to the Booker acquisition and the Notes and added Booker as a new borrower under the senior secured credit facility.

Convertible Senior Notes

In June 2018, the Company issued \$310,500,000 aggregate principal amount of 0.375% convertible senior notes due 2023 in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act. The net proceeds from the issuance of the Notes were \$301,728,000, after deducting the initial purchasers’ discounts and transaction costs.

The Notes are governed by an indenture (the “Indenture”) between the Company, as the issuer, and U.S. Bank National Association, as trustee. The Notes are the Company’s senior unsecured obligations and rank senior in right of payment to any of the Company’s indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to any of the Company’s unsecured indebtedness that existing and future liabilities that are not so subordinated; effectively junior in right of payment to any of the Company’s secured indebtedness, including the Company’s indebtedness under the senior secured credit facility, to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of the Company’s subsidiaries. The Indenture does not contain any financial covenants or restrictions on the payments of dividends, the incurrence of indebtedness, or the issuance or repurchase of securities by the Company or any of its subsidiaries. The Notes mature on June 1, 2023 unless earlier repurchased or redeemed by the Company or earlier converted in accordance with their terms prior to the maturity date. Interest is payable semi-annually in arrears on June 1 and December 1 of each year, beginning on December 1, 2018.

The Notes have an initial conversion rate of 20.1898 shares of Class A common stock per \$1,000 principal amount of Notes, which is equal to an initial conversion price of approximately \$49.53 per share of Class A common stock, and is subject to adjustment in some events. Following certain corporate events that occur prior to the maturity date or following the Company’s issuance of a notice of redemption, the Company will, in certain circumstances, increase the conversion rate for a holder who elects to convert its Notes in connection with such corporate event or during the related redemption period in certain circumstances. Additionally, upon the occurrence of a corporate event that constitutes a “fundamental change” per the Indenture, holders of the Notes may require the Company to repurchase for cash all or a portion of their Notes at a purchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest.

On or after December 1, 2022, until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert all or any portion of their Notes at any time regardless of whether the conditions set forth below have been met. Upon conversion, holders will receive cash, shares of the Company’s Class A common stock or a combination of cash and shares of Class A common stock, at the Company’s election. The Company intends to settle the principal of the Notes in cash.

Holders of the Notes may convert all or any portion of their Notes at any time prior to the close of business on the business day immediately preceding December 1, 2022, in integral multiples of \$1,000 principal amount, only under the following circumstances:

during any calendar quarter commencing after the calendar quarter ending on September 30, 2018 (and only during such calendar quarter), if the last reported sale price of the Company's Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading

day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price for the Notes on each applicable trading day;
 during the five business day period after any 10 consecutive trading day period (the “measurement period”) in which the trading price per \$1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company’s Class A common stock and the conversion rate on each such trading day;
 if the Company calls any or all of the Notes for redemption, at any time prior to the close of business on the scheduled trading day immediately preceding the redemption date; or
 upon the occurrence of corporate events, specified in the Indenture.

The Company may not redeem the notes prior to June 6, 2021. The Company may redeem for cash all or any portion of the Notes, at the Company’s option, on or after June 6, 2021 if the last reported sale price of the Company’s Class A common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period (including the last trading day of such period) ending on, and including, the trading day immediately preceding the date on which the Company provides notice of redemption at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date. No sinking fund is provided for the Notes.

As of September 30, 2018, the condition allowing holders of the Notes to convert have not been met and therefore the Notes are not yet convertible. The notes are classified as long-term debt.

Transaction costs attributable to the liability component were \$6,710,000 and are being amortized to interest expense using the effective interest method over the term of the Notes, and transaction costs attributable to the equity components were \$2,062,000 and netted with the equity component of the Notes in stockholders’ equity. The net carrying value of the liability component of the Notes was as follows (in thousands):

	September 30, 2018
Liability component:	
Principal	\$ 310,500
Less: unamortized debt discount	69,136
Less: unamortized transaction costs	6,418
Net carrying amount	\$ 234,946

The unamortized issuance costs as of September 30, 2018 will be amortized over a weighted-average remaining period of approximately 4.13 years.

The net carrying amount of the equity component of the Notes was as follows (in thousands):

	September 30, 2018
Proceeds allocated to the conversion option (debt discount)	\$ 72,969
Less: transaction cost	2,062
Net carrying amount	\$ 70,907

The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Three Months		Nine Months	
	Ended	Ended	Ended	Ended
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
Contractual interest expense	\$ 291	\$ —	\$ 349	\$ —
Amortization of debt discount	3,198	—	3,833	—
Amortization of transaction costs	245	—	293	—
Total	\$ 3,734	\$ —	\$ 4,475	\$ —

The effective interest rate of the liability component for the nine months ended September 30, 2018 was 6.50%. Based on the closing price of our Class A common stock of \$40.65 on September 28, 2018, the if-converted value of the Notes was less than their respective principal amounts.

Capped Call

In connection with the offering of the Notes, the Company paid \$36,422,000 to enter into Capped Calls. The Capped Calls each have an initial strike price of approximately \$49.53 per share, subject to certain adjustments, which corresponds to the initial conversion price of the Notes. The Capped Calls have initial cap prices of \$76.20 per share, subject to certain adjustments (the “Cap Price”). The Capped Calls cover, subject to anti-dilution adjustments, approximately 6.3 million shares of Class A common stock. The Capped Calls are intended to reduce or offset the potential dilution of the Company’s Class A common stock upon any conversion of the Notes, and/or offset any cash payments the Company is required to make in excess of the principal amount of converted Notes, with such reduction and/or offset subject to a cap based on the Cap Price. The Capped Calls are recorded as a reduction to additional paid-in capital and are not accounted for as derivatives.

Impact on Earnings Per Share

The Notes will not have an impact on the Company’s diluted earnings per share until the average market price of its Class A common stock exceeds the conversion price of \$49.53 per share, as the Company intends to settle the principal amount of the Notes in cash upon conversion. The Company is required under the treasury stock method to compute the potentially dilutive shares of common stock related to the Notes for periods the Company reports net income. However, upon conversion, there will be no economic dilution from the Notes until the average market price of the Company’s Class A common stock exceeds the Cap Price of \$76.20 per share, as exercise of the Capped Calls offsets any dilution from the Notes from the conversion price up to the Cap Price. Capped Calls are excluded from the calculation of diluted earnings per share, as they would be anti-dilutive under the treasury stock method.

8. COMMITMENTS AND CONTINGENCIES

Operating Lease

The Company has operating lease agreements with lease periods expiring between 2019 and 2030. Rent expense was \$2,262,000 and \$1,705,000 for the three months ended September 30, 2018 and 2017, respectively. Rent expense was \$6,336,000 and \$4,575,000 for the nine months ended September 30, 2018 and 2017, respectively.

Financing Obligation

The Company occupies office space in San Luis Obispo, California, constructed under a 15 year build-to-suit lease arrangement for which the Company is considered the “deemed owner” for accounting purposes. The lease has an initial term of 15 years, and the Company has an option to extend the term of the lease for three consecutive terms of five years each. The portion of the lease obligation allocated to the building for accounting purposes is being treated as a financing obligation. The portion of the lease obligation allocated to the land for accounting purposes is being treated as an operating lease. The financing obligation is being settled through the monthly lease payments. In the table below, the remaining future minimum lease payments on the building, leased, include interest of \$8,229,000 to be recognized over the remainder of the initial term of the lease agreement. The total financing obligation as of September 30, 2018 is \$15,065,951, of which \$587,000 is recorded as a current obligation.

Future Minimum Lease Payments

Future minimum lease payments under non-cancellable lease agreements as of September 30, 2018 were as follows (in thousands):

Year Ending December 31,	Operating Leases	Financing Obligation, Building-Leased	Total
2018 (Remaining three months)	\$ 1,575	\$ 423	\$ 1,998
2019	6,051	1,729	7,780
2020	5,840	1,781	7,621
2021	4,573	1,835	6,408
2022	3,269	1,890	5,159
Thereafter	10,134	15,637	25,771
Total minimum lease payments	\$ 31,442	\$ 23,295	\$ 54,737

Purchase Commitments

Future unconditional purchase commitments for software subscriptions and data center and communication services as of September 30, 2018 were as follows (in thousands):

Year Ending December 31,	
2018 (Remaining three months)	\$ 742
2019	3,703
2020	2,188
2021	676
Total purchase commitments	\$ 7,309

Litigation

From time to time, the Company may become involved in legal proceedings, claims, and litigation arising in the ordinary course of business. Management is not currently aware of any matters that it expects would have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

9. COMMON STOCK AND STOCKHOLDER'S EQUITY

Common Stock

Immediately prior to the completion of MINDBODY's initial public offering ("IPO"), all outstanding shares of common stock were reclassified into 11,305,355 shares of Class B common stock, and the Company's certificate of incorporation was amended and restated to authorize the Company to issue 1,000,000,000 shares of Class A common stock and 100,000,000 shares of Class B common stock, each with a par value of \$0.000004 per share. The amended and restated certificate of incorporation also:

established that, on any matter that is submitted to a vote of the stockholders, the holder of each share of Class A common stock is entitled to 1 vote per share, while the holder of each share of Class B common stock is entitled to 10 votes per share;

established that shares of Class B common stock are convertible into shares of Class A common stock at the option of the holder and automatically convert into shares of Class A common stock upon transfer, subject to limited exceptions; and

established that, except with respect to voting and conversion rights, as discussed above, the rights of the holders of Class A and Class B common stock are identical.

Following the IPO, the number of outstanding shares of Class A common stock has increased, with an associated decrease in the number of shares of outstanding Class B common stock, primarily as a result of the conversion of shares of Class B common stock held by pre-IPO investors and stockholders into shares of Class A common stock. In addition, several options have been exercised and RSUs (as defined herein) have vested, as well as purchases under the Company's 2015 ESPP (as defined herein), all resulting in an increase in the number of shares of Class A common stock. Finally, in May 2017, the number of shares of Class A common stock increased as a result of the issuance of 5,060,000 shares of Class A common stock in the Company's follow-on public offering.

2015 Equity Incentive Plan

The Company's 2015 Equity Incentive Plan ("2015 Plan") became effective on June 17, 2015 and serves as the successor to the Company's 2009 Stock Option Plan ("2009 Plan"). As of September 30, 2018, there were 6,780,316 shares of Class A common stock available for issuance under the 2015 Plan. The number of shares available for issuance under the 2015 Plan includes an annual increase on the first day of each fiscal year beginning in 2016, equal to the least of 3,915,682 shares, 5% of the outstanding shares of common stock as of the last day of the immediately preceding fiscal year, or such other amount as the Company's board of directors or compensation committee may determine. Accordingly, effective as of January 1, 2018, the number of shares available for issuance under the 2015 Plan was increased by 2,347,168 shares of Class A common stock. All stock options under the 2015 Plan have a term of no greater than ten years from the date of grant. As of September 30, 2018, options to purchase 1,506,491 shares of Class A common stock and 2,278,153 restricted stock units ("RSUs"), which will be settled in shares of Class A common stock, remained outstanding under the 2015 Plan.

The 2015 Plan provides for the grant of non-statutory stock options, restricted stock awards ("RSAs"), RSUs, stock appreciation rights, performance units and performance shares to the Company's employees, directors and consultants and its parent and subsidiary corporations' employees and consultants. Neither RSAs nor RSUs require payment from the employee or service provider. Each RSA and RSU represents the right to receive one share of Class A common stock upon vesting or settlement, as applicable. The RSUs generally vest over a period of approximately one or four years depending on the nature of the award. These awards are contingent upon the related employees' continuous employment with the Company. As such, compensation expense is being recorded over the requisite service period of one or four years.

2015 Employee Stock Purchase Plan

The Company's 2015 Employee Stock Purchase Plan ("ESPP") became effective on June 2, 2015. As of September 30, 2018, there were 1,256,244 shares of Class A common stock available for issuance under the ESPP. The number of shares available for sale under the ESPP includes an annual increase on the first day of each fiscal year beginning in 2016, equal to the least of 783,136 shares, 1% of the outstanding shares of common stock as of the last day of the immediately preceding fiscal year, or such other amount as the Company's board of directors or compensation committee may determine. Accordingly, effective as of January 1, 2018, the number of shares available for issuance under the ESPP was increased by 469,433 shares of Class A common stock.

Under the ESPP, eligible employees are granted options to purchase shares of Class A common stock through payroll deductions. The ESPP provides for 24-month offering periods. Each offering period includes four purchase periods, which are approximately six-month periods commencing with one exercise date and ending with the next exercise date. At the end of each purchase period, employees are able to purchase shares at 85% of the lower of the fair market value of the Class A common stock on the first trading day of each offering period or the end of each six-month purchase period. New offering periods commence every six months on or about February 22 and August 22 of each year. Employees purchased 245,914 shares of Class A common stock for an aggregate cost of \$4,261,000 under the ESPP during the nine months ended September 30, 2018.

2009 Stock Option Plan

The 2009 Plan, which provides for the grant of incentive stock options, non-statutory stock options, and restricted stock to employees, directors, and consultants terminated on June 18, 2015. Accordingly, no shares were available for issuance under the 2009 Plan after that time. The 2009 Plan continues to govern outstanding awards granted thereunder. As of September 30, 2018, options to purchase 1,900,671 shares of Class B common stock remained

outstanding under the 2009 Plan.

Booker Equity Incentive Plan

28

In connection with the acquisition of Booker, the Company assumed each outstanding and unexercised vested option to purchase Booker common stock. All such securities, or approximately 73,900 common stock awards, became issuable for shares of the Company's Class A common stock. Booker's Equity Incentive Plan is no longer active.

RSU and RSA Activity

A summary of the activity for the Company's RSUs and RSAs is presented below (in thousands, except share numbers and per share amounts):

	Number of Shares	Weighted-Average Grant Date Fair Value (per share)	Aggregate Intrinsic Value
Unvested balance – December 31, 2017	1,322,650	\$ 23.14	\$ 40,275
Granted	1,514,316	38.43	
Vested	(356,557)	22.90	
Forfeited	(202,256)	28.03	
Unvested balance – September 30, 2018	2,278,153	\$ 32.91	\$ 92,607

As of September 30, 2018, there was a total of \$65,382,000 in unrecognized compensation cost related to unvested RSUs, which is expected to be recognized over a weighted average period of approximately 2.8 years.

Stock Option Activity

A summary of the activity for the Company's stock option plans during the reporting periods and a summary of information related to options vested and expected to vest and options exercisable are presented below (in thousands, except shares, per share amounts, and contractual life years):

	Options Outstanding Number of Shares	Weighted-Average Exercise Price	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding – December 31, 2017	3,436,048	\$ 13.44		6.8	\$ 58,605
Granted	670,039	35.34	\$ 14.30		
Exercised	(483,975)	12.77			13,492
Forfeited or canceled	(149,321)	20.96			
Outstanding – September 30, 2018	3,472,791	\$ 17.43		6.7	\$ 80,700
Exercisable – September 30, 2018	2,096,794	\$ 10.69		5.4	\$ 62,816
Vested and expected to vest – September 30, 2018	3,457,102	\$ 17.38		6.6	\$ 80,526

The total fair value of options vested during the three and nine months ended September 30, 2018 was \$2,305,000 and \$6,066,000, respectively, and during the three and nine months ended September 30, 2017 was \$977,000 and \$3,670,000, respectively.

As of September 30, 2018, the total unrecognized stock-based compensation expense for unvested stock options, net of expected forfeitures, was \$14,491,000, which is expected to be recognized over a weighted-average period of 2.6 years.

Other Stock-Based Compensation

The Company recorded stock-based compensation expense during the three and nine months ended September 30, 2018 of \$265,000 and \$787,000, respectively, and during the three and nine months ended September 30, 2017 of \$265,000 and \$543,000, respectively, attributed to post-acquisition services that are payable in shares of the

Company's common stock.

29

Determination of Fair Value

The Company records stock-based compensation based on the fair value of stock options on grant date using the Black-Scholes option-pricing model. The Company determines the fair value of shares of common stock to be issued under the ESPP using the Black-Scholes option-pricing model.

The following table summarizes the assumptions used in the Black-Scholes option-pricing model to determine the fair value of stock options granted:

	Nine Months Ended	
	September 30,	
	2018	2017
Expected term (in years)	5.2	5.8
Expected volatility	37% - 38%	40% - 44%
Risk-free interest rate	2.6% - 3.0%	1.8% - 2.0%
Dividend yield	0%	0%

The following table summarizes the assumptions used in the Black-Scholes option-pricing model to determine fair value of common shares to be issued under the ESPP:

	Nine Months Ended	
	September 30,	
	2018	2017
Expected term (in years)	0.5 - 2.0	0.5 - 2.0
Expected volatility	33% - 38%	31% - 50%
Risk-free interest rate	1.7% - 2.8%	0.5% - 1.3%
Dividend yield	0%	0%

Total Stock-Based Compensation Expense

Total stock-based compensation expense related to stock options, ESPP and restricted stock units and awards is included in the consolidated statements of operations as follows (in thousands):

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Cost of revenue	\$680	\$287	\$1,762	\$914
Sales and marketing	2,015	836	5,400	2,013
Research and development	2,381	1,167	5,741	2,674
General and administrative	2,546	1,625	6,937	4,324
Total stock-based compensation expense	\$7,622	\$3,915	\$19,840	\$9,925

10. INCOME TAXES

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act, among other things, reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, changes rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017, and creates new taxes on certain foreign sourced earnings. On December 31, 2017, the Company remeasured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%. However, the Company is still analyzing certain aspects of the Act and refining its calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts.

The Deemed Repatriation Transition Tax (“Transition Tax”) is a tax on previously untaxed accumulated and current earnings and profits (“E&P”) of certain of our foreign subsidiaries. To determine the amount of the Transition Tax, the Company must determine, in addition to other factors, the amount of post-1986 E&P of the relevant subsidiaries, as well as the amount of non-U.S. income taxes paid on such earnings. The Company was able to make a reasonable estimate of the Transition Tax and recorded a provisional Transition Tax obligation. However, the Company is continuing to gather additional information to more precisely compute the amount of the Transition Tax.

The income tax expense of \$169,000 for the three months ended September 30, 2018 is primarily attributable to the deferred tax liability associated with the amortization of indefinite lived intangible assets, foreign income taxes associated with the Company’s operations in the United Kingdom and Australia, and U.S. state income taxes. The Company’s effective tax rate for the three months ended September 30, 2018 and 2017 was negative 1.0% and negative 2.3%, respectively.

The income tax benefit of \$1,811,000 for the nine months ended September 30, 2018 is primarily attributable to the partial release of \$2,133,000 of the U.S. valuation allowance in conjunction with the acquisition of FitMetrix since the acquired net deferred tax liabilities will provide a source of income for the Company to realize a portion of its deferred tax assets, for which a valuation allowance is no longer needed (see Note 5 – “Business Combinations”). The Company’s effective tax rate for the nine months ended September 30, 2018 and 2017 was 4.8% and negative 3.0%, respectively.

11. NET LOSS PER SHARE

The following table sets forth the computation of the Company’s basic and diluted net loss per share attributable to common stockholders for the periods presented (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net loss attributable to common stockholders	\$(17,237)	\$(3,630)	\$(35,819)	\$(11,914)
Net loss per share attributable to common stockholders, basic and diluted	\$(0.36)	\$(0.08)	\$(0.75)	\$(0.27)
Weighted-average shares used to compute net loss per share attributable to common stockholders, basic and diluted	47,808	46,460	47,491	43,475

Diluted loss per common share is the same as basic loss per common share for all periods presented because the effects of potentially dilutive items were anti-dilutive given the Company’s net loss. The following shares have been excluded from the calculation of diluted net loss per share attributable to common stockholders for each period presented because they are anti-dilutive (in thousands):

	As of September 30,	
	2018	2017
Shares subject to outstanding stock options and employee stock purchase plan	3,520	3,876
Shares subject to outstanding restricted stock units	2,278	1,293
Total	5,798	5,169

12. SEGMENTS AND INFORMATION BY GEOGRAPHIC LOCATION

Operating segments are components of an enterprise for which separate financial information is available and is evaluated regularly by the Company’s chief operating decision maker in deciding how to allocate resources and assessing performance. The Company’s chief operating decision maker is its Chief Executive Officer.

The Chief Executive Officer reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. Further, there is one business activity, and there are no

segment managers who are held accountable for operations, operating results, and plans for levels, components, or types of products or services below the consolidated unit level. Accordingly, the Company has a single operating and reporting segment.

Substantially all of the Company's assets were attributable to operations in the United States as of September 30, 2018 and December 31, 2017.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below and those discussed in the section titled "Risk Factors" included in Item 1A of Part II of this Quarterly Report on Form 10-Q.

Overview

We are the leading technology platform for the fitness, beauty and wellness services industries and a rapidly growing marketplace for these services. As of September 30, 2018, our customers employed more than 469,000 wellness practitioners serving more than 58 million active consumers in more than 100 countries. We are also a leading payments platform dedicated to the fitness, beauty and wellness services industries, transacting approximately \$2,674 million and \$1,971 million on our payments platform for the three months ended September 30, 2018 and 2017, respectively, representing a 36% increase year over year.

We provide our software as a subscription-based service to our 67,364 subscribers, as of September 30, 2018. We market and sell subscriptions for our platform to small and medium-sized businesses within the fitness, beauty and wellness services industries, targeting the United States, Canada, the United Kingdom, Ireland, Australia, New Zealand, Hong Kong, and Singapore. In the first quarter of 2018 we simplified our MINDBODY software packaging, offering the following three software levels to our customers: Essential, Accelerate and Ultimate.

Our integrated software and payments platform creates powerful network effects. As more local wellness businesses adopt our platform, more customer listings appear on the MINDBODY app and third-party partner sites available through MINDBODY Promote (formerly referred to as the "MINDBODY Network"). As awareness of these businesses increases through these marketing channels, they attract more consumers to our platform. Those consumers then attract even more businesses to our platform. As those businesses and consumers engage in more transactions on our platform, payments and API revenue increases resulting in additional revenue streams from demand generation. Finally, as we add more customers and consumers to our wellness ecosystem, we attract more technology developers and partners who can use our open API to develop additional apps that extend the capabilities of our open platform. We intend to continue scaling our organization in order to meet the needs of our customers. We also intend to continue growing the inventory of fitness, beauty and wellness services on our marketplace. We have invested and expect to continue to invest in our sales and marketing teams to sell our platform globally, including, in particular, to high value subscribers in the countries noted above. A key element of our growth strategy is the continuous enhancement and expansion of our software and payments platform, as well as our marketplace, by continuously developing and implementing new features and functionality. Through consistent innovation and strategic acquisitions, we have increased both the number of high value subscribers and the revenue we generate from our customers over time.

We plan to continue to enhance our software architecture and enhance and expand our platform through ongoing investments in research and development and sales and marketing, and by pursuing strategic acquisitions of complementary businesses and technologies that will enable us to continue to drive growth in the future.

We also expect to continue to make investments in both our data center infrastructure and our customer service and customer onboarding teams to meet the needs of our growing user base.

While these areas represent significant opportunities for us, we also face significant risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results. Due to our continuing investments to grow our business, we are continuing to incur expenses in the near term from which we may not realize any long-term benefit. In addition, any investments that we make in sales and marketing or other areas will occur in advance of our experiencing any benefits from such investments, so it may be difficult for us to

determine if we are efficiently allocating our resources in these areas.

32

Set forth below are summary financial highlights for the three and nine months ended September 30, 2018:

	Three Months			Nine Months		
	Ended	Change		Ended	Change	
	September 30,			September 30,		
	2018	2017	%	2018	2017	%
	(dollars in millions)					
Revenue	\$63.8	\$46.6	37%	\$179.2	\$132.9	35%
Net loss	(17.2)	(3.6)		(35.8)	(11.9)	
Adjusted EBITDA ⁽¹⁾	\$(0.7)	\$2.5		\$3.4	\$5.3	

⁽¹⁾ For a reconciliation of Adjusted EBITDA to net loss, see the section below titled “Non-GAAP Financial Measure.” During the three months ended September 30, 2018 and 2017, approximately 82% and 80% of our revenue came from the United States, respectively. During the nine months ended September 30, 2018 and 2017, approximately 81% of our revenue came from the United States, respectively.

Our employee headcount increased to 1,802 employees as of September 30, 2018, from 1,440 as of September 30, 2017.

Key Metrics

We regularly review the following key metrics to measure our performance, identify trends affecting our business, formulate financial projections, make strategic business decisions and assess working capital needs.

	As of and for the	
	Three Months	
	Ended September	
	2018	2017
Subscribers (end of period)	67,364	59,028
Average monthly revenue per subscriber	\$309	\$259
Payments volume (in millions)	\$2,674	\$1,971
Dollar-based net expansion rate (average for the quarter)	101 %	108 %

Subscribers. Subscribers are defined as unique physical locations or individual practitioners who have active subscriptions to our services, including MINDBODY, Booker or FitMetrix, as of the end of the period. Subscribers or customers do not include locations or practitioners who only use Frederick (our marketing automation software). The overall number of subscribers has increased year over year from 59,028 to 67,364. We believe the number of subscribers is one indicator of the growth of our platform, but the revenue contribution of individual subscribers can vary widely. For example, the vast majority of our revenue is generated from our high value subscribers. High value subscribers are defined as any customer on our platform, including FitMetrix customers and Booker customers, exclusive of those customers on the Solo software level. The number of subscribers on our Solo software level has decreased from 4,370 as of September 30, 2017 to 456 as of September 30, 2018, and the number of our high value subscribers increased from 54,658 as of September 30, 2017 to 66,908 as of September 30, 2018. Growth in the number of our high value subscribers depends, in part, on our ability to successfully develop and market our platform to wellness businesses and consumers who have not yet become part of our network. We expect the number of high value subscribers and overall subscribers to fluctuate over time.

Average Monthly Revenue per Subscriber. We believe that our ability to increase the average monthly revenue per subscriber, which we also refer to as ARPS, is an indicator of our ability to increase the long-term value of our existing subscriber relationships. ARPS is calculated by dividing the subscription and services and payments revenue generated in a given month by the number of subscribers at the end of the previous month. For periods greater than one month, ARPS is the sum of the average monthly revenue per subscriber for each month in the applicable period, divided by the number of months in the period. For example, the ARPS measurement period in the table above was

measured over each of the three months ended September 30, 2018 and 2017. ARPS increased for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. We expect ARPS to increase over the long term.

Payments Volume. We believe that payments volume is an indicator of the underlying current health of our customers' businesses and of consumer spending trends as well as being a major driver of our payments revenue. Payments volume is the total dollar volume of transactions between our customers and consumers utilizing our payments platform. Payments volume increased for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. We expect payments volume to continue to increase over the long term.

Dollar-Based Net Expansion Rate. Our business model focuses on maximizing the lifetime value of a customer relationship. We can achieve this by focusing on delivering more value and improved functionality that retains our existing customers and by expanding the revenue derived from our customers over the lifetime of the relationship by selling higher value subscriptions to customers on lower software levels, through the utilization of our premium customer support offering, by increasing the value of transactions processed through our payments platform, and through services provided by our API and technology partners. We assess our performance in this area by measuring our dollar-based net expansion rate. Our dollar-based net expansion rate provides a measurement of our ability to increase revenue across our existing customer base, offset by churn, downgrades in subscriptions, reduction in services utilization and reductions in the value of transactions that our customers process through our payments platform. Our dollar-based net expansion rate is based upon our monthly subscription and services and payments revenue for a set of customer accounts. We calculate our dollar-based net expansion rate by dividing our retained revenue net of contraction and churn by our base revenue. We define our base revenue as the aggregate monthly subscription and services and payments revenue of our customer base as of the date one year prior to the date of calculation. We define our retained revenue net of contraction and churn as the aggregate monthly subscription and services and payments revenue of the same customer base included in our measure of base revenue at the end of the period being measured. We expect our dollar based net expansion rate to fluctuate over time.

Non-GAAP Financial Measure

Adjusted EBITDA

To provide investors with additional information regarding our financial results prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), we have presented Adjusted EBITDA, which is a non-GAAP financial measure defined by us as our net loss before (1) stock-based compensation expense, (2) depreciation and amortization, (3) acquisition-related expenses, including, transaction and integration expenses, (4) income tax provision (benefit), and (5) other expense, net, which consisted of interest income, interest expense, and other income (expense), net. Prior period acquisition-related expenses were insignificant. Accordingly, prior periods have not been adjusted to reflect these expenses.

We have provided below a reconciliation of Adjusted EBITDA to net loss, the most directly comparable GAAP financial measure. We have presented 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, we believe that the exclusion of the amounts eliminated in calculating Adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. 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.

The 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 financial results as reported under GAAP. Some of these limitations are as follows:

Adjusted EBITDA excludes stock-based compensation expense, which has been, and will continue to be for the foreseeable future, a significant recurring expense in our business;

Although depreciation and amortization expense are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;

Adjusted EBITDA does not reflect cash requirements for acquisition-related expenses or tax payments; and

Other companies, including companies in our industry, may calculate Adjusted EBITDA or similarly titled measures differently, which reduces its usefulness as a comparative measure.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Net loss	\$(17,237)	\$(3,630)	\$(35,819)	\$(11,914)
Stock-based compensation expense	7,622	3,915	19,840	9,925
Depreciation and amortization	5,589	2,337	13,544	6,736
Acquisition-related expenses	579	—	4,867	—
Income tax provision (benefit)	169	83	(1,811)	343
Other (income) expense, net	2,567	(217)	2,766	181
Adjusted EBITDA	\$(711)	\$2,488	\$3,387	\$5,271

Components of Statements of Operations

Revenue

See Note 2 – “Revenue Recognition,” contained in the “Notes to Condensed Consolidated Financial Statements” in Item I of Part I of this Quarterly Report on Form 10-Q.

Cost of Revenue

Cost of revenue primarily consists of costs associated with personnel and related infrastructure for operation of our cloud-based business management platform, data center operations, global customer support and onboarding services, payment processing for customers that pay via credit card, and allocated overhead. Personnel costs consist of salaries, benefits, bonuses and stock-based compensation. Overhead consists of certain facilities costs, depreciation expense, amortization expense associated with acquired intangible assets, information technology costs, and impairment charges for acquired intangible assets and internally developed software.

Operating Expenses

Our operating expenses consist of sales and marketing, research and development, and general and administrative expenses.

Sales and marketing. Sales and marketing expense consists primarily of personnel costs, including salaries, benefits, bonuses, stock-based compensation and commission costs for our sales and marketing personnel. Sales and marketing expense also includes costs for market development programs, advertising, lead generation, promotional and other marketing activities, and allocated overhead. Sales and marketing expense is our largest operating expense, driving growth in customers, ARPS and consumer adoption, and we expect to continue to increase this expense in absolute dollars as we increase our sales and marketing efforts, including consumer marketing efforts, although such expense may fluctuate as a percentage of total revenue. Historically, we expensed all these costs as incurred, but in connection with the adoption of Topic 606, we are capitalizing incremental costs of obtaining a contract with a customer, and we amortize this cost over a four-year period providing a temporary reduction in sales and marketing personnel costs. See Note 2 – “Revenue Recognition,” contained in the “Notes to Condensed Consolidated Financial Statements” in Item I of Part I of this Quarterly Report on Form 10-Q for a description of the impact of the capitalization of incremental costs of obtaining a contract with a customer.

Research and development. Research and development expense consists primarily of personnel costs, including salaries, benefits, bonuses, and stock-based compensation for our development personnel. Research and development expense also includes outsourced software development costs and allocated overhead. We expect research and development expense to continue to increase in absolute dollars as we continue to invest in our research and product development efforts to enhance our product capabilities and access new markets, although such expense may fluctuate as a percentage of total revenue.

General and administrative. General and administrative expense consists primarily of personnel costs, including salaries, benefits, bonuses, and stock-based compensation for our executive, finance, legal, human resources, information technology, and other administrative personnel. General and administrative expense also includes acquisition-related expenses, including transaction expenses, consulting, legal and accounting services, allocated overhead, and other expenses associated with compliance with the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”) and other regulations governing public companies. We will continue to incur additional costs associated with being a public company including legal, corporate insurance and accounting expenses. We also expect to incur further integration expenses associated with the acquisition of Booker, which closed on April 2, 2018. We expect general and administrative expense to continue to increase in absolute dollars as we grow our operations and operate as a public company, although such expense may fluctuate as a percentage of total revenue.

Other Income and Expenses

Our other income and expenses line items consist of interest income (expense), net, and other expense, net.

Interest income. Interest income consists primarily of the interest earned on our short-term investments and cash and cash equivalent balances.

Interest expense. Interest expense consists primarily of interest expense associated with the 0.375% convertible senior notes due 2023 (the “Notes”), including the amortization of debt discount and transaction related costs, and the interest incurred on the financing obligation associated with our build-to-suit lease arrangement. We entered into a loan agreement with Silicon Valley Bank in 2015 for a secured revolving credit facility (the “senior secured credit facility”), and any future draws on this loan agreement will incur interest expense and result in increased interest expense in future periods. This loan agreement is set to expire in January 2019.

Other income (expense), net. Other income (expense), net, consists primarily of gains and losses on disposals of property and equipment and gains and losses from foreign currency transactions.

Income Tax Provision (Benefit)

Income tax provision (benefit) consists primarily of federal and state income taxes in the United States, income taxes in certain foreign jurisdictions in which we conduct business, and the partial release of our valuation allowance as a result of net deferred tax liabilities assumed in business acquisitions. We have a full valuation allowance for net U.S. deferred tax assets, including net operating loss carryforwards. We expect to maintain this full valuation allowance for the foreseeable future.

Results of Operations

The following tables set forth our results of operations data in dollars and as a percentage of revenue for the periods presented. The period-to-period comparison of results of operations is not necessarily indicative of results to be expected for future periods.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
(in thousands)				
Consolidated Statements of Operations Data:				
Revenue	\$63,782	\$46,612	\$179,216	\$132,933
Cost of revenue	20,189	13,123	55,027	37,880
Gross profit	43,593	33,489	124,189	95,053
Operating expenses:				
Sales and marketing	25,959	18,514	68,845	52,210
Research and development	18,960	8,976	48,295	26,426
General and administrative	13,175	9,763	41,913	27,807
Total operating expenses	58,094	37,253	159,053	106,443
Loss from operations	(14,501)	(3,764)	(34,864)	(11,390)
Interest income	1,482	485	2,581	808
Interest expense	(4,040)	(313)	(5,374)	(933)
Other income (expense), net	(9)	45	27	(56)
Loss before provision for income taxes	(17,068)	(3,547)	(37,630)	(11,571)
Income tax provision (benefit)	169	83	(1,811)	343
Net loss	\$(17,237)	\$(3,630)	\$(35,819)	\$(11,914)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
(as a percentage of revenue)				

Consolidated Statements of Operations Data:				
Revenue	100 %	100 %	100 %	100 %
Cost of revenue	32 %	28 %	31 %	28 %
Gross profit	68 %	72 %	69 %	72 %
Operating expenses:				
Sales and marketing	41 %	40 %	38 %	39 %
Research and development	30 %	19 %	27 %	20 %
General and administrative	20 %	21 %	23 %	21 %
Total operating expenses	91 %	80 %	88 %	80 %
Loss from operations	(23)%	(8)%	(19)%	(8)%
Interest income	2 %	— %	1 %	— %
Interest expense	(6)%	— %	(3)%	— %
Other income (expense), net	— %	— %	— %	— %
Loss before provision for income taxes	(27)%	(8)%	(21)%	(8)%
Income tax provision (benefit)	— %	— %	1 %	(1)%
Net loss	(27)%	(8)%	(20)%	(9)%

Comparison of the Three and Nine Months Ended September 30, 2018 and 2017

Revenue

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2018	2017	\$	%	2018	2017	\$	%
	(dollars in thousands)							
Revenue:								
Subscription and services	\$40,792	\$28,283	\$12,509	44%	\$112,075	\$79,228	\$32,847	41%
Payments	22,037	17,786	4,251	24%	64,532	52,155	12,377	24%
Product and other	953	543	410	76%	2,609	1,550	1,059	68%
Total revenue	\$63,782	\$46,612	\$17,170	37%	\$179,216	\$132,933	\$46,283	35%

Revenue increased \$17.2 million, or 37%, in the three months ended September 30, 2018 compared to the three months ended September 30, 2017. Subscription and services revenue increased \$12.5 million, or 44%, of which \$11.3 million was due to additional subscribers from the acquisition of Booker, price increases, upgrading subscribers to higher-priced software tiers, increased adoption of our branded mobile app, Frederick, and FitMetrix offerings, and an improvement in the mix to high value subscribers. \$1.2 million of the increase was due to an increase in revenue from our API and technology partners. Payments revenue increased \$4.3 million, or 24%, due to increased volume of transactions processed by our subscribers on our payments platform, both from existing MINDBODY subscribers and additional Booker subscribers. Product and other revenue increased \$0.4 million, or 76%, due to hardware sales. We expect our revenue to increase over time through both organic growth and acquisitions.

Revenue increased \$46.3 million, or 35%, in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. Subscription and services revenue increased \$32.8 million, or 41%, of which \$28.1 million was due to the additional subscribers from the acquisition of Booker, price increases, upgrading subscribers to higher-priced software tiers, the increased adoption of our branded mobile app, Frederick, and FitMetrix offerings, and an improvement in the mix to high value subscribers. \$4.8 million of the increase was due to an increase in revenue from our API and technology partners. Payments revenue increased \$12.4 million, or 24%, due to increased volume of transactions processed by our subscribers on our payments platform, both from existing MINDBODY subscribers and additional Booker subscribers. Product and other revenue increased \$1.1 million, or 68%, due to hardware sales. We expect our revenue to increase over time through both organic growth and acquisitions.

Cost of Revenue and Gross Margin

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2018	2017	\$	%	2018	2017	\$	%
	(dollars in thousands)							
Cost of revenue	\$20,189	\$13,123	\$7,066	54%	\$55,027	\$37,880	\$17,147	45%
Gross profit	\$43,593	\$33,489	\$10,104	30%	\$124,189	\$95,053	\$29,136	31%
Gross margin	68	% 72	%		69	% 72	%	

Cost of revenue increased \$7.1 million, or 54%, in the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase was attributable to a \$3.2 million increase in personnel-related expenses due to an increase in headcount, primarily from the Booker acquisition. The increase was also due to a \$3.0 million increase in infrastructure costs, consulting, and hardware cost of sales, and a \$0.6 million increase in amortization of acquired technology and internally developed software.

Cost of revenue increased \$17.1 million, or 45%, in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The increase was attributable to an \$8.0 million increase in personnel-related

expenses due to an increase in headcount, primarily from the Booker acquisition. The increase was also due to a \$7.0 million increase in infrastructure costs, consulting, and hardware cost of sales, and a \$1.5 million increase in amortization of acquired technology and internally developed software.

As of September 30, 2018, we had 665 employees dedicated to data center operations, global customer support and onboarding services as compared to 535 employees as of September 30, 2017. Gross margins decreased as a result of an increase in amortization of acquired technology and internally developed software and because of Booker's lower gross margin.

Operating Expenses

Sales and Marketing

Three Months Ended		Change		Nine Months Ended		Change		
September 30, 2018	2017	\$	%	September 30, 2018	2017	\$	%	
(dollars in thousands)								
Sales and marketing	\$25,959	\$18,514	\$7,445	40%	\$68,845	\$52,210	\$16,635	32%

Sales and marketing expense increased \$7.4 million, or 40%, in the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase was attributable to a \$4.9 million increase in personnel-related expenses due to an increase in headcount, primarily from the Booker acquisition, which includes a \$1.2 million increase in stock-based compensation expense. The increase in sales and marketing expense also includes a \$2.4 million increase in amortization of acquired intangible assets, and a \$2.3 million increase in promotional spending and other marketing programs, including our annual BOLD user conference which we held in September 2018. These increases were partially offset by a \$3.2 million net deferral of contract acquisition costs in connection with the adoption of Topic 606. For a discussion of Topic 606, refer to Note 1 – “Summary of Business and Significant Accounting Policies,” and Note 2 – “Revenue Recognition,” contained in the “Notes to Condensed Consolidated Financial Statements” in Item 1 of Part I of this Quarterly Report on Form 10-Q. Besides the additional headcount resulting from the Booker acquisition, the increase in personnel-related expenses before taking into account the deferral of contract acquisition costs was due to our focus on building a dedicated and skilled full-time sales team workforce.

Sales and marketing expense increased \$16.6 million, or 32%, in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The increase was attributable to an \$11.1 million increase in personnel-related expenses due to an increase in headcount, primarily from the Booker acquisition, which includes a \$3.4 million increase in stock-based compensation expense, a \$6.1 million increase in promotional spending and other marketing programs, a \$4.7 million increase in amortization of acquired intangible assets, a \$1.1 million increase in travel and entertainment expenses related to the integration of the recent acquisitions as well as additional travel in the normal course of business, a \$0.9 million increase in internal-use software, and a \$0.7 million increase in third party consulting services. These increases were partially offset by an \$8.7 million net deferral of contract acquisition costs in connection with the adoption of Topic 606. For a discussion of Topic 606, refer to Note 1 – “Summary of Business and Significant Accounting Policies,” and Note 2 – “Revenue Recognition,” contained in the “Notes to Condensed Consolidated Financial Statements” in Item 1 of Part I of this Quarterly Report on Form 10-Q. Besides the additional headcount resulting from the Booker acquisition, the increase in personnel-related expenses before taking into account the deferral of contract acquisition costs was due to our focus on building a dedicated and skilled full-time sales team workforce.

As of September 30, 2018, we had 585 employees, which includes eight part-time employees dedicated to sales and marketing, as compared to 508 employees, which included 48 part-time employees, as of September 30, 2017.

Research and Development

Three Months Ended		Change		Nine Months Ended		Change	
September 30, 2018	2017	\$	%	September 30, 2018	2017	\$	%
(dollars in thousands)							

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

Research and development \$18,960 \$8,976 \$9,984 111% \$48,295 \$26,426 \$21,869 83%

Research and development expense increased \$10.0 million, or 111%, in the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase was attributable to a \$7.2 million increase in personnel-related expenses due to an increase in headcount, inclusive of the Booker acquisition and a \$1.2 million increase in stock-based compensation, and an increase of \$1.1 million in outsourced development costs and consulting.

Research and development expense increased \$21.9 million, or 83%, in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The increase was attributable to a \$16.9 million increase in personnel-related expenses due to an increase in headcount, inclusive of the Booker acquisition and a \$3.1 million increase in stock-based compensation, an increase of \$3.0 million in outsourced development costs and consulting, and a \$0.8 million increase in internal-use software.

As of September 30, 2018, we had 362 employees dedicated to research and development as compared to 233 employees as of September 30, 2017.

General and Administrative

	Three Months Ended September 30, 2018		Change		Nine Months Ended September 30, 2018		Change	
	2018	2017	\$	%	2018	2017	\$	%
	(dollars in thousands)							
General and administrative	\$13,175	\$9,763	\$3,412	35%	\$41,913	\$27,807	\$14,106	51%

General and administrative expense increased \$3.4 million, or 35%, in the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The increase was primarily attributable to a \$2.5 million increase in personnel-related expenses, including a \$0.9 million increase in stock-based compensation, and a \$0.6 million increase in acquisition-related expenses associated with the acquisition of Booker.

General and administrative expense increased \$14.1 million, or 51%, in nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The increase was primarily attributable to a \$7.1 million increase in personnel-related expenses, including a \$2.6 million increase in stock-based compensation, a \$4.9 million increase in acquisition-related expenses associated with the acquisitions of Booker and FitMetrix, a \$0.7 million increase in internal-use software, and \$0.5 million in additional costs for compliance with Section 404 of the Sarbanes-Oxley Act.

As of September 30, 2018, we had 190 employees dedicated to general and administrative as compared to 164 employees as of September 30, 2017.

Interest Income, Interest Expense, Other Income (Expense), net, and Income Tax Provision (Benefit)

	Three Months Ended September 30, 2018		Change		Nine Months Ended September 30, 2018		Change	
	2018	2017	\$	%	2018	2017	\$	%
	(dollars in thousands)							
Interest income	\$1,482	\$485	\$997	206%	\$2,581	\$808	\$1,773	219%
Amortization of debt discount and transaction costs for convertible senior notes	3,444	—	3,444		4,126	—	4,126	
Contractual interest expense on convertible senior notes	291	—	291		349	—	349	
Interest on financing obligation, building-leased	291	301	(10)	()	872	899	(27)	()
Other	14	12	2		27	34	(7)	()
Total interest expense	\$4,040	\$313	\$3,727	1,191%	\$5,374	\$933	\$4,441	476%
Other income (expense), net	\$(9)	\$45	\$(54)	(120)%	\$27	\$(56)	\$83	(148)%
Income tax provision (benefit)	\$169	\$83	\$86	104%	\$(1,811)	\$343	\$(2,154)	(628)%

Interest income increased during the three and nine months ended September 30, 2018 compared to the three and nine months ended September 30, 2017 as a result of interest income earned on higher cash balances, which are invested in money market funds and available-for-sale short-term investments.

Interest expense increased during the three and nine months ended September 30, 2018 compared to the three and nine months ended September 30, 2017 as a result of the amortization of debt discount and transaction costs for the convertible senior notes and the contractual interest payable twice a year.

As a result of the acquisition of FitMetrix, we recorded a tax benefit of \$2.1 million as a discrete item in the first quarter. This tax benefit is a result of the partial release of our existing U.S. valuation allowance in conjunction with the acquisition since the acquired net deferred tax liabilities from FitMetrix will provide a source of income for us to realize a portion of our deferred tax assets, for which a valuation allowance is no longer needed.

Liquidity and Capital Resources

We believe that our existing cash and cash equivalents and short-term investments balance will be sufficient to meet our working capital requirements for at least the next 12 months. However, our liquidity assumptions may prove to be incorrect, and we could utilize our available financial resources sooner than we currently expect. Our future capital requirements and the adequacy of available funds will depend on many factors, including our growth rate, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, and those factors set forth in Part II, Section 1A - "Risk Factors" of this Quarterly Report on Form 10-Q. We cannot assure you that we will be able to raise additional capital on acceptable terms or at all. In addition, if we fail to meet our operating plan during the next 12 months, our liquidity and ability to operate our business could be adversely affected.

The following table summarizes our cash and cash equivalents, short-term investments, and our cash flows as of and for the periods presented (in thousands):

	As of September 30,	
	2018	2017
Cash and cash equivalents	\$ 154,074	\$ 225,312
Short-term investments	171,016	—
Total cash and cash equivalents and short-term investments	\$ 325,090	\$ 225,312
	Nine Months Ended September 30,	
	2018	2017
Cash provided by (used in) operating activities	\$(7,511)	\$ 5,524
Cash used in investing activities	330,160	7,242
Cash provided by financing activities	259,836	140,967

Operating Activities

During the nine months ended September 30, 2018, operating activities used \$7.5 million in cash, primarily as a result of a \$7.9 million change in operating assets and liabilities, net. The change in operating assets and liabilities was primarily a result of a \$9.7 million increase in deferred commissions in relation to Topic 606 and a \$2.4 million increase in prepaid expenses and other current assets, offset by a \$2.1 million net increase in accounts payable, accrued expenses, and other liabilities and a \$1.4 million increase in deferred revenue. The net increase in accounts payable, accrued expenses, and other liabilities was due to the increase in employment related expenses and the timing of payments to our vendors and employees, partially as a result of the Booker acquisition. Our net loss of \$35.8 million was offset by \$36.2 million in net adjustments for non-cash stock-based compensation expense, depreciation and amortization, and partial release of the valuation allowance. Our consolidated net loss of \$35.8 million included a net loss of \$8.8 million from the consolidation of Booker's financial results and \$4.9 million of acquisition related

expenses.

During the nine months ended September 30, 2017, operating activities provided \$5.5 million in cash, primarily as a result of \$16.7 million of non-cash expenses included in our net loss of \$11.9 million, and \$0.8 million provided by the net change in operating assets and liabilities. The non-cash expenses primarily consisted of \$9.9 million of stock-based compensation expense and \$6.7 million of depreciation and amortization expense. The net change in operating assets and liabilities was primarily a result

41

of a \$1.9 million increase in accounts payable, accrued expenses, and other liabilities and a \$1.2 million increase in deferred revenue, which were partially offset by a \$0.8 million increase in accounts receivable, and a \$2.0 million increase in prepaid expenses and other current assets. The increase in accounts payable, accrued expenses, and other liabilities was due to the increase in headcount and the timing of payments to our vendors and employees.

Investing Activities

During the nine months ended September 30, 2018, investing activities used \$330.2 million as a result of \$136.6 million and \$15.2 million paid in cash for the acquisitions of Booker and FitMetrix, respectively. \$171.1 million in purchases of short-term investments, \$5.9 million in purchases of property and equipment, and additions of intangible assets through the capitalization of qualifying development costs of \$1.4 million.

During the nine months ended September 30, 2017, investing activities used \$7.5 million as a result of \$5.8 million in purchases of property and equipment and \$1.5 million cash paid in a business acquisition.

Financing Activities

During the nine months ended September 30, 2018, net cash provided by financing activities was \$259.8 million, consisting primarily of \$301.8 million in proceeds from the issuance of the Notes, net of initial purchasers' discounts and paid transaction costs, \$6.2 million in proceeds from the exercise of equity awards by employees, and proceeds from our employee stock purchase plan of \$4.3 million. The cash inflows were partially offset by the purchase of a capped call option for \$36.4 million related to the issuance of the Notes, a \$10.0 million repayment of long-term debt of Booker, \$4.4 million in tax payments related to employee shares withheld from RSUs vesting during the period and final holdback payments of \$1.3 million for prior business acquisitions.

During the nine months ended September 30, 2017, net cash provided by financing activities was \$141.0 million, consisting primarily of the issuance of Class A common stock in the amount of \$134.3 million, exercise of equity awards of \$5.6 million, and proceeds from our employee stock purchase plan of \$3.2 million, partially offset by \$1.6 million in payments for employee taxes for shares withheld from RSUs vesting during the period.

Contractual Obligations and Commitments

Our principal commitments consist of obligations under non-cancelable leases for our office space in San Luis Obispo, California and unconditional purchase commitments for software subscriptions and communication services. For additional information, see Note 8 – “Commitments and Contingencies” contained in the “Notes to Condensed Consolidated Financial Statements” in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Off Balance Sheet Arrangements

As of September 30, 2018, we did not have any relationships with unconsolidated entities or financial partnerships, such as structured finance or special purpose entities that were established for the purpose of facilitating off-balance sheet arrangements or other purposes.

Segment Information

We have one primary business activity and operate in one reportable segment.

Critical Accounting Policies and Estimates

For a discussion of critical accounting policies and estimates, refer to Note 1 – “Summary of Business and Significant Accounting Policies” contained in the “Notes to Condensed Consolidated Financial Statements” in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Recently Issued and Adopted Accounting Pronouncements

For a discussion of new accounting pronouncements, refer to Note 1 – “Summary of Business and Significant Accounting Policies” contained in the “Notes to Condensed Consolidated Financial Statements” in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Exchange Risk

We have foreign currency risks related to our revenue and expenses denominated in currencies other than the U.S. Dollar, principally the British Pound Sterling, the Euro and the Australian Dollar, which are subject to fluctuations due to changes in foreign currency exchange rates. Additionally, fluctuations in foreign currency exchange rates may cause us to recognize transaction gains and losses in our statements of operations. To date, foreign currency transaction gains and losses have not been material to our financial statements, and we have not engaged in foreign currency hedging transactions. A hypothetical 10% change in foreign currency exchange rates during any of the periods presented would not have had a material impact on our consolidated financial statements. As our international operations grow, we will continue to reassess our approach to managing the risks relating to fluctuations in currency rates.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our cash and cash equivalents and short-investments as of September 30, 2018. Our cash and cash equivalents as of September 30, 2018 were \$154.1 million, primarily consisting of cash and money market funds. Our short-term investments as of September 30, 2018 were \$171.0 million, consisting primarily of U.S. Government bonds, commercial paper, corporate bonds, and Treasury bills. Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of the interest rates in the United States. However, because of the short-term nature of our interest-bearing securities, a 10% change in market interest rates would not be expected to have a material impact on our consolidated financial condition or results of operations.

In June 2018, we issued \$310.5 million aggregate principal amount of 0.375% Notes. The Notes have fixed annual interest rates at 0.375% and, therefore, we do not have economic interest rate exposure on the Notes. However, the values of the Notes are exposed to interest rate risk. Generally, the fair value of our fixed interest rate Notes will increase as interest rates fall and decrease as interest rates rise. We carry the Notes at face value less unamortized discount on our balance sheet, and we present the fair value for required disclosure purposes only.

Item 4. Controls and Procedures

Limitations on Effectiveness of Controls

In designing and evaluating the disclosure controls and procedures, 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.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. 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, or 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 Securities and Exchange Commission’s, or 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, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required

disclosure.

Changes in Internal Control over Financial Reporting

In April 2018, we completed our acquisition of Booker, which is being integrated into our operational systems. We also implemented certain internal controls related to our January 1, 2018 adoption of guidance issued by the Financial Accounting

43

Standards Board on revenue and acquisition costs from contracts with customers. Other than with respect to these items, there was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

From time to time we may become involved in legal proceedings or be subject to claims arising in the ordinary course of our business. We are not presently a party to any legal proceedings that in the opinion of our management, if determined unfavorably to us, would have a material adverse effect on our business, financial condition, operating results or cash flows. Regardless of the outcome, litigation can, among other things, be time consuming and expensive to resolve, and divert management resources.

Item 1A. Risk Factors

Investing in our Class A common stock involves a high degree of risk. You should carefully consider the following risks, together with all of the other information contained in this Quarterly Report on Form 10-Q, including our financial statements and related notes, before making a decision to invest in our Class A common stock. Any of the following risks could have a material adverse effect on our business, operating results, and financial condition and could cause the trading price of our Class A common stock to decline, which would cause you to lose all or part of your investment.

Risks Related to Our Business

We have a history of losses, and we may not achieve or maintain profitability in the future. In addition, our revenue growth rate may not sustain the levels experienced in recent years.

We have incurred a net loss in each year since our inception, including a net loss of \$14.8 million, \$23.0 million and \$36.1 million in the years ended December 31, 2017, 2016 and 2015, respectively, and \$35.8 million and \$11.9 million in the nine months ended September 30, 2018 and 2017, respectively. We have expended and expect to continue to expend financial and other resources on, among other things:

continuing the development of, and ongoing improvements to, our platform, including research and development investments in our technology infrastructure, the development or acquisition of new products, features and functionality and improvements to the scalability, availability and security of our platform;

strategic acquisitions;

sales and marketing expenses, including personnel, lead generation and consumer advertising expenses;

expenses related to international expansion in an effort to increase our customer and consumer base; and

general and administrative expenses, including legal, regulatory, accounting and other expenses related to being a public company.

If we expend more resources on growing our business than currently anticipated or if we encounter unforeseen operating expenses, difficulties, complications and other unknown factors, we may not be able to achieve or sustain profitability and our operating results and business would be harmed.

For the years ended December 31, 2017, 2016 and 2015, our revenue was \$182.6 million, \$139.0 million and \$101.4 million, respectively, representing a 31% and 37% growth rate, respectively. For the nine months ended September 30, 2018 and 2017, our revenue was \$179.2 million and \$132.9 million, respectively, representing a 35% growth rate. Our historical revenue growth rates are not necessarily indicative of future growth, and we may not achieve similar revenue growth rates in future periods.

If we fail to increase market acceptance of our platform, enhance and adapt our platform to changing market dynamics and customer preferences, or keep pace with technological developments, our business, results of operations, financial condition and growth prospects would be adversely affected.

We derive, and expect to continue to derive, a majority of our revenue and cash inflows from our integrated cloud-based business management software and payments platform for the fitness, beauty and wellness services industries. As such, market acceptance of this platform is critical to our success. Our ability to attract new customers, increase revenue from existing customers, or cross-sell products from acquired companies, depends in part on our ability to enhance and improve our existing platform and to introduce new and innovative features, products and services, including features, products and services designed for a mobile user environment. Demand for our platform is affected by a number of factors, many of which are beyond our control, such as the timing of development and release of new products, features and functionality by our competitors, technological change, consumer preferences and growth or contraction in our addressable market.

To grow our business, we must develop features, products and services that reflect the changing nature of business management software, are designed with appropriate security and expand beyond our core scheduling and point-of-sale functionality to other areas of managing relationships with our customers and consumers. For example, in 2013, we expanded our platform to include MINDBODY Connect (now the MINDBODY app), in 2015 we introduced the MINDBODY Marketing Platform (now MINDBODY Promote), in 2017 we introduced dynamic pricing, and in 2018 we introduced the FitMetrix, Frederick and Booker products, which we acquired. The success of these and any other enhancements to our platform depends on several factors, including timely completion, appropriate security, adequate quality testing and sufficient customer or consumer demand. Any new feature, product or service that we acquire or develop may not be introduced in a timely or cost-effective manner, may contain defects, may lack appropriate security, and/or may not achieve the market acceptance necessary to generate sufficient revenue. For example, we recently acquired Booker to expand the capabilities of our platform to engage with more consumers in our marketplace and expand our leadership in wellness and beauty. To date, a large portion of the wellness and beauty industry has not adopted the type of business management software that we provide, and our future success is dependent upon this market's acceptance of our platform to provide more value to these customers and consumers of wellness and beauty services. If we are unable to successfully introduce new, secure, and innovative features, products or services, meet the demands and expectations of our customers and consumers for features, products and services that meet their needs and are easy to use and deploy, or enhance our existing platform to meet customer requirements, our ability to achieve widespread market acceptance of our platform will be undermined, and our business, results of operations, financial condition and growth prospects will be adversely affected.

In addition, because our platform is available over the Internet, we need to continuously modify and enhance our platform to keep pace with changes in Internet-related hardware, software, communications and database technologies and standards, including security standards. If we are unable to respond in a timely and cost-effective manner to these rapid technological developments and changes in standards, our platform may become less marketable, less competitive, or obsolete, and our operating results will be harmed. If new technologies emerge that are able to deliver competitive products and applications at lower prices, more efficiently, more conveniently or more securely, such technologies could adversely impact our ability to compete. Our platform must also integrate with a variety of network, hardware, mobile and software platforms and technologies, and we need to continuously modify and enhance our products and services to adapt to changes and innovation in these technologies. Any failure of our platform to operate effectively with future infrastructure platforms and technologies could reduce the demand for our platform. If we are unable to respond to these changes in a cost-effective manner, our platform may become less marketable, less competitive or obsolete, and our operating results may be adversely affected.

Our business depends substantially on our customers renewing, upgrading, or expanding their subscriptions to our platform and our ability to sell subscriptions to a large number of new small and medium-sized businesses on a consistent basis and in a cost-effective manner. Any decline in the rate at which customers renew, upgrade, or expand their subscriptions could harm our future operating results.

The vast majority of our subscription revenue is derived from subscriptions to our platform that have monthly terms, with some larger customers on longer term contracts. For us to maintain or improve our operating results, it is important that our customers renew, upgrade and/or expand their subscriptions. Our retention rate may decline or fluctuate as a result of a number of factors, including our customers' satisfaction with our platform, accessibility of our platform, our customer support, our prices, the prices of competing software systems, system uptime, network performance, data breaches, mergers and acquisitions affecting our customer base, the effects of global economic conditions and the strength of our customers' businesses. If our customers do not renew and/or expand their subscriptions or renew but shift to lower priced software subscriptions, our revenue may decline and we may not realize improved operating results from our customer base.

In addition, even if our market grows as expected, our business depends on our sales team's ability to sell subscriptions to a large number of new small and medium-sized businesses on a consistent basis, with each sale constituting only a small portion of our overall revenue. To achieve this type of customer growth and expansion in a cost-effective manner, it is crucial that our platform is easy to use and implement and remains accessible to our customers through our distribution channels without the need for excessive post-sale customer support. If we are unable to sell a large

volume of subscriptions on a consistent basis, if we are forced to incur excessive costs to provide post-sale customer support, or if we are unable to retain, upgrade, or expand offerings to our existing customers, our business, results of operations, financial condition and growth prospects will be adversely affected.

If pricing for our software subscriptions is not acceptable to our customers, our operating results will be harmed.

We have, from time to time, increased the price of our software subscriptions and may do so again in the future. For example, we have implemented several price increases over the past few years, including most recently starting in February 2018 for some of our software levels. We believe these increases have caused and may continue to cause customers to leave our platform, and such increases may also have reduced, and in the future may reduce, the number of new customers adopting our software. We cannot guarantee that new or existing customers will adopt or renew subscriptions at our current prices. Additionally, in the future

we may further refine our tiered pricing model and our software levels, and/or increase pricing. Such further changes may cause customers to migrate to lower level offerings or leave our platform entirely, which would adversely affect our customer numbers, and could adversely affect our revenue, gross margin, profitability, financial position and cash flow.

If our network or computer systems are breached, unauthorized access to customer or consumer data is otherwise obtained, or denial-of-service attacks occur, our platform may be perceived as insecure, we may lose existing customers or fail to attract new customers, and we may incur significant liabilities.

Use of our platform, including some of our third-party applications, involves the storage, transmission and processing of our customers' proprietary data, including personal or identifying information regarding their clients or employees. As a result, unauthorized access to, security breaches of, or denial-of-service attacks against our platform could result in the unauthorized access to or use of, and/or loss of, such data, as well as loss of intellectual property or trade secrets.

If any unauthorized access to our systems or data, security breach, or significant denial-of-service attack occurs or is believed to have occurred, our reputation and brand could be damaged, we could be required to expend significant capital and other resources to alleviate problems caused by such actual or perceived breaches or attacks and remediate our systems, and we could be exposed to a risk of loss, litigation or regulatory action and possible liability, some or all of which may not be covered by insurance, and our ability to operate our business may be impaired. We have in the past and may in the future experience denial-of-service attacks against our platform. If potential new customers or existing customers believe that our platform does not provide adequate security for the storage of personally identifiable or sensitive information or its transmission over the Internet, they may not adopt our platform or may choose not to renew their subscriptions to our platform, which could harm our business. For example, we recently had certain customer records of FitMetrix exposed publicly. Management acted promptly to resolve the exposure and believes there may be additional costs incurred to address the matter. Additionally, actual, potential or anticipated attacks may cause us to incur increasing costs, including costs to deploy additional personnel and protection technologies, train employees, and engage third-party experts and consultants. Our errors and omissions insurance policies covering certain security and privacy damages and claim expenses may not be sufficient to compensate for all potential liability. Although we maintain cyber liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all.

Because the techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. We may also experience security breaches that may remain undetected for extended periods of time.

Because data security is a critical competitive factor in our industry, we make statements in our privacy policies and terms of service, through our certifications to privacy standards, and in our marketing materials, describing the security of our platform, including descriptions of certain security measures we employ. Should any of these statements be untrue, become untrue, or be perceived to be untrue, even if through circumstances beyond our reasonable control, we may face claims, including claims of unfair or deceptive trade practices, brought by the U.S. Federal Trade Commission, state, local or foreign regulators (e.g., a European Union-based data protection agency) or private litigants.

Because our platform can be used to collect and store personal information, domestic and international privacy and data security concerns could result in additional costs and liabilities to us or inhibit sales of our platform.

Our customers can use our platform to use, collect and store personal or identifying information regarding their employees and clients. Federal, state and foreign governments and agencies have adopted laws and regulations concerning the collection and use of personally identifiable information obtained from their residents or by businesses operating within their jurisdiction. The costs of compliance with and other burdens imposed by privacy-related laws, regulations and standards may limit the use or adoption of our platform, reduce overall demand for our platform, lead to significant fines, penalties or liabilities for noncompliance, or slow the pace at which we close sales transactions, any of which could harm our business. Moreover, if our employees fail to adhere to adequate data protection practices

around the usage of our customers' data, it may damage our reputation and brand.

We also expect that there will continue to be new proposed laws, regulations and industry standards concerning privacy, data protection and information security in the United States, the European Union and other jurisdictions, and we may not be able to predict the impact such future laws, regulations and standards may have on our business. For example, in April 2016, the EU Parliament formally adopted the General Data Protection Regulation (“GDPR”), which supersedes existing EU data protection legislation, imposes more stringent EU data protection requirements, and provides for greater penalties for noncompliance. The GDPR went into effect on May 25, 2018. Specifically, the GDPR introduced numerous privacy-related changes for companies operating in the EU, including greater control for data subjects (e.g., the “right to be forgotten”), increased data portability for EU consumers, data breach notification requirements, and increased fines. In particular, under the GDPR, fines of up to 20 million

euros or up to 4% of the annual global revenue of the noncompliant company, whichever is greater, could be imposed for violations of certain of the GDPR's requirements. The GDPR requirements apply not only to third-party transactions, but also to transfers of information between us and our subsidiaries, including employee information.

Complying with the GDPR has caused us to incur operational costs and divert attention from other operational priorities. Despite our efforts to bring practices into compliance before the effective date of the GDPR, we may not be successful either due to internal or external factors such as resource allocation limitations. Non-compliance could result in proceedings against us by governmental entities, customers, data subjects or others. We may find it necessary to establish systems to maintain personal data originating from the EU in the European Economic Area or protect a person's privacy, which may involve substantial expense and distraction from other aspects of our business. In the meantime, there could be uncertainty as to how to comply with EU privacy law.

The implementation of GDPR has led other jurisdictions to either amend, or propose legislation to amend their existing data privacy and cybersecurity laws to resemble the requirements of GDPR. For example, on June 27, 2018, California adopted the California Consumer Privacy Act of 2018 ("CCPA"). The CCPA has been characterized as the first "GDPR-like" privacy statute to be enacted in the United States because it mirrors a number of the key provisions in the GDPR. Because of this, we may need to engage in additional compliance efforts, including data mapping to identify the personal information we are collecting and the purposes for which such information is collected and enhanced consumer controls with respect to their data. All of this will need to be done before the effective date of the CCPA on January 2, 2020.

Additionally, in July 2016, the European Union and the United States adopted a new framework for legitimizing trans-Atlantic data flows, the EU-U.S. Privacy Shield. Uncertainty remains as to whether the EU-U.S. Privacy Shield and other legal mechanisms for the lawful transfer of data from the European Union to the United States will withstand legal challenges, whether from regulators or private parties. If one or more of the legal bases for transferring data from Europe to the United States is invalidated, it could affect the manner in which we provide our services or adversely affect our financial results. Moreover, if our privacy and data policies and practices, are, or are perceived to be, insufficient, customer demand for our platform could decline, and our business could be negatively impacted. Domestic laws in this area are also complex and developing rapidly. The U.S. Federal Trade Commission and numerous state attorneys general are applying federal and state consumer protection laws to enforce regulations related to the online collection, use and dissemination of personally identifiable information and other data. Some of these requirements include obligations on companies to notify individuals of security breaches involving particular personal information, which could result from breaches experienced by us or our service providers. For example, our solutions must conform, in certain circumstances, to requirements set forth in the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"), which governs the privacy and security of protected health information. Through the provision of online scheduling services to certain of our customers, we may collect, access, use, maintain and transmit protected health information in ways that may be subject to certain of these laws and regulations.

Many state legislatures have adopted legislation that regulates how businesses operate online, including measures relating to privacy, data security and data breaches. Laws in all 50 states require businesses to provide notice to customers whose personally identifiable information has been disclosed as a result of a data breach. The laws are not consistent, and compliance in the event of a widespread data breach is costly. Further, states are constantly amending existing laws, requiring attention to frequently changing regulatory requirements. For example, Delaware amended its data breach notification law in order to expand what constitutes "personal information" to require breach notification to the Delaware Attorney General, and to require the provision of credit monitoring in certain circumstances. Additionally, because we process a significant portion of our payments through debit or credit cards and enable our customers to engage in payments through our service, we are contractually required to maintain Payment Card Industry Data Security Standard, ("PCI DSS"), compliance as part of our information security program. We also may be bound by additional, more stringent contractual obligations relating to our collection, use and disclosure of personal, financial and other data. If we cannot comply with or if we incur a violation of any of these regulations or

requirements, we could incur significant liability through fines and penalties imposed by credit card associations or other organizations or breach of contracts with our payment processors, either of which could have an adverse effect on our reputation, business, financial condition and operating results.

Finally, in March 2017, the U.K. government invoked Article 50 of the Lisbon Treaty to initiate the process to leave the European Union, which follows the results of the referendum in June 2016 in which the United Kingdom voted to leave the European Union. The impact of the foregoing on data and privacy regulations in the United Kingdom remains uncertain.

We may find it necessary to change our business practices or expend significant resources to modify our software or platform to adapt to new laws, regulations and industry standards concerning these matters. We may be unable to make such

changes and modifications in a commercially reasonable manner or at all. Any failure to comply with federal, state or foreign laws or regulations, industry standards or other legal obligations, or any actual or suspected security incident, may result in governmental enforcement actions and prosecutions, private litigation, fines, penalties or adverse publicity and could cause our customers to lose trust in us, which could have an adverse effect on our reputation and business.

Interruptions or performance problems associated with our technology and infrastructure may adversely affect our business and operating results.

Our continued growth depends in part on the ability of our existing and potential customers and consumers to access our platform at any time and within an acceptable amount of time. Our platform is proprietary, and we rely on the expertise of members of our engineering, operations and software development teams for our platform's continued performance. In addition, we depend on external data centers to host our applications. While we control and have access to our servers located in our external data centers, we do not control the operation of these facilities. We are also dependent on a number of third-party cloud-based service providers of critical corporate infrastructure services relating to, among other things, human resources, electronic communication services and some finance functions, and we are dependent on the security systems of these providers. We have experienced, and may in the future experience, disruptions, outages and other performance problems related to our platform due to a variety of factors, including infrastructure changes, introductions of new functionality, human or software errors, delays in scaling our technical infrastructure if we do not maintain enough excess capacity and accurately predict our infrastructure requirements, capacity constraints due to an overwhelming number of users accessing our platform simultaneously, denial-of-service attacks or other security-related incidents. For example, we are in the process of upgrading and improving our systems to enable new products and services and accommodate future growth. Recently, following the installation of a new release, we experienced a series of events that resulted in an interruption in our service for several hours. From time to time we have also been the subject of denial-of-service attacks that have rendered our core software inaccessible for several hours. In some instances, we may not be able to identify the cause or causes of these performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve our performance, especially during peak usage times and as our platform becomes more complex and our user traffic increases due to, among other things, a growing number of customers and consumers originating from and demanding service in a greater number of countries. If our platform is unavailable or if our users are unable to access our platform within a reasonable amount of time, or at all, our business would be adversely affected and our brand could be harmed. In the event of any of the factors described above, or certain other failures of our infrastructure, customer or consumer data may be permanently lost. Moreover, our agreements with customers typically provide for limited service level commitments. Our customers may be eligible for, and we may provide, credits toward future service for which we will not receive revenue if we are unable to meet these service level commitments. If we experience significant periods of service downtime in the future, we may be subject to claims by our customers against these service level commitments. 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 adversely affected.

Real or perceived errors, failures, or bugs in our platform could adversely affect our operating results and growth prospects.

Because our platform is complex, undetected errors, failures, vulnerabilities or bugs may occur, especially when updates are deployed or if there are issues with our secure access management procedures. Our platform is often used in connection with computing environments with different operating systems, system management software, equipment and networking configurations, which may cause errors in or failures of our platform or other aspects of the computing environments. In addition, deployment of our platform into complicated, large-scale computing environments may expose undetected errors, failures, vulnerabilities or bugs in our platform. Despite testing by us, errors, failures, vulnerabilities or bugs may not be found in our platform until after it is deployed to our customers or consumers. We have discovered, and expect to discover in the future, software errors, failures, vulnerabilities and bugs in our platform, and we anticipate that certain of these errors, failures, vulnerabilities and certain bugs can only be discovered and remediated after deployment to customers. Real or perceived errors, failures or bugs in our

platform could result in negative publicity, loss of or delay in market acceptance of our platform, loss of competitive position or claims by customers for losses sustained by them. In such an event, we may be required, or may choose for customer relations or other reasons, to expend additional resources in order to help correct the problem and or repair goodwill with our customers.

Our payments platform is a core element of our business, and any failure to grow and develop our payment processing activities, or to anticipate changes in consumer behavior, could materially and adversely affect our business and financial results.

Our payments platform is a core element of our business. For the years ended December 31, 2017, 2016 and 2015, our payments platform generated 39%, 39% and 37% of our total revenue, respectively. For the nine months ended September 30, 2018 and 2017, our payments platform generated 36% and 39% of our total revenue, respectively.

Our future success depends in large part on the continued growth and development of our payments platform. If such activities are limited, restricted, curtailed or degraded in any way, or if we fail to continue to grow and develop such activities, our business may be materially and adversely affected.

The continued growth and development of our payments platform will depend on our ability to anticipate and adapt to changes in consumer behavior. For example, consumer behavior may change regarding the use of payment types, including the relative increased use of cash, ACH, crypto-currencies, card-based transactions, and other emerging or alternative payment methods and payment systems that we or our processing partners do not adequately support or that do not provide adequate commissions to Independent Sales Organizations such as us. Any failure to timely integrate emerging payment methods (e.g., Alipay, Bitcoin or other crypto-currencies) into our software, anticipate consumer behavior changes, or contract with processing partners that support such emerging payment technologies could cause us to lose traction among our customers, resulting in a corresponding loss of revenue, in the event such methods become popular among their consumers.

Our payments platform is subject to U.S. and international rules and regulations, some of which are still developing. If we fail to comply with such rules and regulations or if new laws, rules or practices applicable to payment systems restrict our ability to collect fees from our payments platform, our financial results could be materially and adversely effected.

Payment processing is subject to extensive regulation in the United States and other countries where we operate and presents a wide range of risks. We may encounter increased regulatory scrutiny and new regulatory compliance requirements brought about by evolving laws, rules and regulations. Some of the payment processing activities on our platform are subject to price controls within the United States and other countries and may be subject to an increase of price controls, including controls limiting the amount we are allowed to charge customers for processing transactions. In addition, certain countries limit payments-related activities by foreign companies, including by restricting the transfer of funds out of such countries. Changes in the laws, rules or practices applicable to payment systems such as VISA, MasterCard or American Express, among others, including changes resulting in increased costs that we or our customers must pay, may force changes to our payments platform that could adversely affect our business.

If we incur an actual or perceived breach to our payments platform, we may incur significant liabilities and our brand and reputation may be damaged.

We may suffer an attack on our payments platform that results in a breach of consumer cardholder data. We maintain payment records of our customers and consumers on our payments platform, and we are a potential target for hackers and other parties attempting to steal card data via cyber-attacks or other means. As we increase our consumer base and our brand becomes more widely known and recognized, we may become more of a target for these malicious third parties. If we experience any actual or perceived data breach as a result of third-party actions, employee negligence or error, or malfeasance, whether or not resulting in the unauthorized acquisition of or access to cardholder data, we could incur significant liability, our business may suffer and our brand and reputation may be damaged. We could be required to pay extensive fines and costs related to any such data breach, including costs incurred to replace cards and cardholder information and provide security monitoring services, and we could lose future sales and customers, any of which could harm our business and operating results. Such fines and costs could become due soon after such breach and exceed the amount of cash available to us, thereby impacting our ability to operate our business. In addition, a data breach or failure to comply with rules or regulations of payment systems could also result in the termination of our status as a registered Independent Sales Organization/Merchant Service Provider, thereby dramatically impairing our ability to continue doing business in the payments industry.

We are subject to risks related to our reliance on third-party processing partners to perform our payment processing services.

We depend on our third-party processing partners to perform payment processing services. Our processing partners may go out of business or otherwise be unable or unwilling to continue providing such services, which could significantly and materially reduce our payments revenue and disrupt our business. A number of our processing contracts require us to assume liability for any losses our processing partners may suffer as a result of losses caused by our customers, including losses caused by chargebacks and consumer or customer fraud. We have in the past and may

in the future incur losses caused by chargebacks and fraud. In the event of a significant loss by our processing partners, we may be required to remit a large amount of cash following such event and, if we do not have sufficient cash on hand, may be deemed in breach of such contracts. In addition, our customers may be subject to quality issues related to products or services provided by our third-party processing partners or we may become involved in contractual disputes with our processing partners, both of which could impact our reputation and adversely impact our revenue. Certain contracts may expire or be terminated, and we may not be able to replicate the associated revenue through a new processing partner relationship for a considerable period of time.

We have initiated and expect to continue to initiate new third-party payment relationships or migrate to other third-party payment partners in the future. The initiation of these relationships and the transition from one relationship to another could require significant time and resources. Due to non-solicitation obligations under our existing contracts, establishing these new relationships may be challenging. Further, any new third-party payment processing relationships may not be as effective, efficient or well received by our customers and consumers, nor is there any assurance that we will be able to reach an agreement with such processing partners. Our contracts with such processing partners may be less lucrative. For instance, we may be required to pay more for payment processing or receive a less favorable revenue arrangement from our payment processing partners. We may also experience the termination of revenue streams due to such migrations or be subject to claims relating to any disputes that could arise as a result of migrations.

We may undertake to directly perform certain payment processing services and expand the scope of payment processing services we provide, which may require a significant investment of time and resources, and expand our exposure to potential liabilities.

In the future, we may undertake to directly perform certain payment processing services that we currently depend upon our processing partners to perform, expand the scope of payment processing services we provide, offer additional payment processing services or otherwise undertake additional responsibilities and liabilities related to such payment processing services. For example, in the future, we may undertake to act as a registered payment facilitator or payment service provider of the payment systems, providing merchants with a suite of services, including payment processing and funding and accepting payments as the merchant of record on behalf of other merchants. As part of our dynamic pricing functionality, we have undertaken to act as a payment service provider and the merchant of record for those dynamically priced classes booked on our mobile applications, and we may undertake to expand our role as a payment service provider to other areas of our platform. Any of these endeavors could require a significant investment of time and effective management of resources before presenting any potential upside for us and may dramatically expand the scope of our potential contractual liability or exposure in the event of a lawsuit. Further, we may fail to effectively execute in performing such an expansion of services.

The market for business management software is intensely competitive, and if we do not compete effectively, our operating results could be harmed.

The market for business management software for the fitness, beauty and wellness services industries is fragmented and rapidly evolving, with relatively low barriers to entry. We face competition from in-house developed software systems, other software companies, and traditional paper-based methods. Our competitors vary in size and in the breadth and scope of the products and services they offer. In addition, there are a number of companies that are not currently direct competitors but that could in the future shift their focus to the fitness, beauty and wellness services industries and offer competing products and services. Some of these companies, such as Intuit and Square, have or may in the future acquire greater financial and other resources than we do and could bundle competing products and services with their other offerings or offer such products and services at lower prices as part of a larger sale. There is also a risk that certain of our current business partners could terminate their relationships with us and use the insights they have gained from partnering with us to introduce their own competing products. Many of our current and potential competitors have greater name recognition, established marketing relationships, access to larger customer bases and pre-existing relationships with customers, consultants, system integrators and resellers. Additionally, some potential customers in the fitness, beauty and wellness services industries, particularly large organizations, have elected, and may in the future elect, to develop their own business management software. Certain of our competitors have partnered with, or have acquired or been acquired by, and may in the future partner with or acquire, or be acquired by, other competitors to offer services, leveraging their collective competitive positions, which makes, or would make, it more difficult to compete with them. Moreover, we may also face competition from wellness booking services for consumers, or other consumer app or website companies, particularly as we grow our consumer brand and awareness.

Our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. With the introduction of new technologies, the evolution of our platform and new market entrants, we expect competition to intensify in the future. Pricing pressures and increased

competition generally could result in reduced sales, reduced margins, increased churn, reduced customer retention, further losses or the failure of our platform to achieve or maintain more widespread market acceptance, any of which could harm our business. For all of these reasons, we may fail to compete successfully against our current and future competitors, and if such failure occurs, our business will be harmed.

Failure to effectively expand our sales and marketing capabilities could harm our ability to increase our customer base and achieve broader market acceptance of our platform.

Increasing our customer base and number of active consumers, upgrading and expanding services to our existing customers, and achieving broader market acceptance of our platform will depend, to a significant extent, on our ability to effectively expand our sales and marketing operations and activities, including internationally. We are substantially dependent on our marketing organization to generate a sufficient pipeline of qualified sales leads and on our direct sales force to close new customers. From December 31, 2017 to September 30, 2018, our sales and marketing organizations increased from 471 to 585 employees. We plan to expand our direct sales and account development specialist workforce, both domestically and internationally. We believe that there is significant competition for experienced sales professionals with the sales skills and technical knowledge that we require. Our ability to achieve significant revenue growth in the future will depend, in part, on our success in recruiting, training, and retaining a sufficient number of experienced sales professionals. New hires require significant training and time before they achieve full productivity, particularly in new sales segments and territories. Our recent and planned hires may not become productive as quickly as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do business. We cannot predict whether, or to what extent, our sales will increase, our existing customers will upgrade or expand their usage of our platform as we invest in our sales force, or how long it will take for sales personnel to become productive. For example, we recently increased our sales and marketing organization by adding sales personnel. In addition, we are still integrating the Booker sales organization with our broader sales organization. It has taken us longer to both train new hires and integrate these two sales organizations than we initially expected, which has delayed our ability to make our expanding sales organization fully productive. If our marketing organization does not generate a sufficient pipeline of qualified sales leads and our direct sales force is unable to close customers, our business and future growth prospects could be harmed.

Any failure to offer high-quality customer support may adversely affect our relationships with our customers and our financial results.

In deploying and using our platform, our customers depend on our 24/7 customer support team to resolve complex technical and operational issues, including ensuring that our platform is implemented in a manner that integrates with a variety of third-party platforms. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for customer support or to modify the nature, scope and delivery of our customer support to compete with changes in customer support services provided by our competitors. Increased customer demand for customer support, without corresponding revenue, could increase costs and adversely affect our operating results. Our sales are highly dependent on our business reputation and on positive recommendations from our existing customers. Any failure to maintain high-quality customer support, or a market perception that we do not maintain high-quality customer support, could adversely affect our reputation and brand, our ability to sell our platform to existing and prospective customers, our business, operating results and financial position.

Our quarterly results may fluctuate for various reasons, and if we fail to meet the expectations of analysts or investors, our stock price and the value of your investment could decline substantially.

Our quarterly financial results may fluctuate as a result of a variety of factors, many of which are outside of our control. If our quarterly financial results fall below the expectations of investors or any securities analysts who follow our stock, the price of our Class A common stock could decline substantially. Some of the important factors that may cause our revenue, operating results and cash flows to fluctuate from quarter to quarter include but are not limited to:

• our ability to attract new customers, retain and increase sales to existing customers and satisfy our customers' requirements;

• the mix of our customer base, including the concentration of high value subscribers;

• the volume of transactions processed on our payments platform;

• the adoption of our fee-based dynamic pricing marketing services by our customers and consumers;

• significant security breaches, technical difficulties or interruptions to our platform and any related impact on our reputation;

• the variability of revenues derived from our partners;

• the ability to realize benefits from strategic partnerships or acquisitions;

the number of employees added;

the rate of expansion and productivity of our sales force;

- the entrance of new competitors in our market, whether by established companies or new companies;

52

- changes in our or our competitors' pricing;
- the amount and timing of operating costs and capital expenditures related to the expansion of our business, including our sales force, and expenses related to the development or acquisition of technologies or businesses;
- new pricing models, products, features or functionalities introduced by us or our competitors;
- the timing of payments by customers and other payment processing partners and payment defaults by customers or other payment processing partners;
- litigation, including class action litigation, involving our company, our services or our industry;
- general economic conditions or declines in consumer interest in the wellness industries that we serve, either of which may adversely affect either our customers' ability or willingness to purchase additional subscriptions, delay a prospective customer's purchasing decision, reduce the value of new subscription contracts or affect customer retention;
- changes in the relative and absolute levels of customer support we provide;
- changes in foreign currency exchange rates;
- extraordinary expenses such as litigation or other dispute-related settlement payments;
- the impact of new accounting pronouncements; and
- the timing of the grant or vesting of equity awards to employees.

Many of these factors are outside of our control, and the occurrence of one or more of them might cause our revenue, operating results and cash flows to vary widely. As such, we believe that quarter-to-quarter comparisons of our revenue, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

If we fail to effectively manage our growth in a manner that preserves the key aspects of our corporate culture, our business and operating results could be harmed.

We believe that our corporate culture fosters innovation, creativity and teamwork. However, as our organization grows, we may find it increasingly difficult to maintain the beneficial aspects of such culture, and the failure to do so could adversely impact our ability to retain and attract the kind of employees necessary for our future success. If we are unable to manage our anticipated growth and change in a manner that preserves the key aspects of our culture, the quality of our products and services may suffer, which could adversely affect our brand and reputation and harm our ability to retain and attract customers.

We depend on our executive officers and other key employees, and the loss of one or more of these employees or an inability to attract and retain highly skilled employees could adversely affect our business.

Our success depends largely upon the continued services of our executive officers and other key employees, including our Chairman and Chief Executive Officer, Richard Stollmeyer. We rely on our leadership team in the areas of research and development, operations, security, marketing, sales, support, general and administrative functions, and on individual contributors in our research and development and operations, including key employees and highly skilled sales personnel hired through our recent acquisition of Booker. We have experienced, and may in the future experience, changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. We do not have employment agreements with our executive officers or other key personnel that require them to continue to work for us for any specified period, and, therefore, they could terminate their employment with us at any time. The loss of one or more of our executive officers, especially our Chief Executive Officer, or other key employees and highly skilled personnel, could have an adverse effect on our business.

In addition, to execute our growth plan, we must attract and retain highly qualified personnel. Competition for these personnel in the locations where we maintain offices is intense, especially in the San Luis Obispo area, where our headquarters is located, due in part to the relatively close proximity to the San Francisco Bay Area. We have from time to time experienced, and we expect to continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. In some cases, we have recruited employees from the San Francisco Bay Area and other regions with a greater supply of managerial, sales and engineering talent, and in such cases, we have sometimes found it necessary to offer compensation packages that were larger than would have been necessary if no relocation had been required. We also outsource some of our research and development to India, which requires compliance with security protocols. Many of the companies with which we compete for experienced personnel have greater resources than we have and are located in areas in which sales and engineering talent is more readily available. Moreover, job candidates and existing employees often consider the value of the equity awards they receive in connection with their employment. If the perceived value of our equity awards declines, our ability to recruit and retain highly skilled employees may be adversely impacted. If we hire employees from competitors or other companies, their former employers may attempt to assert that these employees have breached their legal obligations, resulting in a diversion of our time and resources. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be adversely affected.

If we are not able to maintain and enhance our brand, then our business, operating results and financial condition may be adversely affected.

We believe that maintaining and enhancing our reputation as a differentiated and category-defining business management software company serving the fitness, beauty and wellness services industries and consumers through a two-sided marketplace is critical to our relationship with our existing customers and to our ability to attract new customers. The successful promotion of our brand attributes will depend on a number of factors, including our marketing efforts, our ability to continue to develop high-quality software, and our ability to successfully differentiate our platform from competitive products and services.

The promotion of our brand requires us to make substantial expenditures, and we anticipate that the expenditures will increase as our market becomes more competitive and as we seek to expand our platform. To the extent that these activities yield increased revenue, this revenue may not offset the increased expenses we incur. If we do not successfully maintain and enhance our brand, our business may not grow, we may have reduced pricing power relative to competitors, and we could lose customers or fail to attract potential customers, all of which would adversely affect our business, results of operations and financial condition.

Unfavorable conditions in our industry or the global economy or reductions in information technology spending could limit our ability to grow our business and adversely affect our operating results.

Our operating results may vary based on the impact of changes in our industry or the global economy on us or our customers. The revenue growth and potential profitability of our business depend on demand for business management software generally and for business management software serving the fitness, beauty and wellness services industries in particular. Historically, during economic downturns, there have been reductions in spending on information technology as well as pressure for extended billing terms and other financial concessions. The adverse impact of economic downturns may be particularly acute among small and medium-sized businesses, which comprise the vast majority of our customer base. If economic conditions deteriorate, our current and prospective customers may elect to decrease their information technology budgets, which would limit our ability to grow our business and adversely affect our operating results.

Our financial results may fluctuate due to increasing variability in our sales cycles resulting from, among other things, an expansion of the focus of our sales efforts to include larger organizations.

We plan our expenses based on certain assumptions about the length and variability of our sales cycle. These assumptions are based upon historical trends for sales cycles and conversion rates associated with our existing customers, many of whom to date have been small to medium-sized organizations. As we expand our sales efforts to include larger organizations, we have incurred and expect to continue to incur higher costs and longer and more unpredictable sales cycles. With larger organizations, the decision to subscribe to our platform may require the approval of more technical personnel and management levels within a potential customer's organization than we have

historically encountered, and if so, these types of sales would require us to invest more time educating these potential customers. In addition, larger organizations may demand more features and integration and customer support services. We have limited experience in developing and managing sales strategies for larger organizations and in successfully onboarding larger organizations as new customers. As a result of these factors, these sales opportunities may not prove to be successful or may require us to devote greater research and development, sales, customer support and professional services resources to individual customers, resulting in increased costs and reduced profitability, and will likely lengthen our typical sales cycle, which could strain our resources. Moreover, these larger transactions may require us to delay recognizing the associated

revenue we derive from these customers until any technical or implementation requirements have been met, and larger customers may demand discounts to the prices they pay for our platform.

Other factors that may influence the length and variability of our sales cycle include but are not limited to:

- our pricing terms;
- the need to educate prospective customers about the uses and benefits of our platform;
- lead generation, including both inbound and outbound;
- the discretionary nature of purchasing and budget cycles and decisions;
- the competitive nature of evaluation and purchasing processes;
- evolving functionality demands;
- announcements or planned introductions of new products, features or functionality by us or our competitors; and
- lengthy purchasing approval processes, particularly among larger organizations.

If we are unsuccessful expanding sales to larger organizations, our business and results of operations could be adversely affected. In addition, if we are unable to close one or more expected significant transactions with customers in a particular period, or if one or more expected transactions are delayed until a subsequent period, our operating results for that period, and for any future periods in which revenue from such transactions would otherwise have been recognized, may be adversely affected.

Our future performance depends in part on our reliance on third-party platforms to distribute our mobile applications, and support from our partner ecosystem.

We rely on third-party distribution platforms, including the Apple App Store and Google Play, for distribution of our mobile applications, including our branded mobile apps. We are subject to these platform providers' standard terms and conditions for application developers, which govern the promotion, distribution and operation of applications on their platforms. If we violate, or if a platform provider believes that we have violated, its terms and conditions, the platform provider may, at its discretion, discontinue or limit our access to their platform. We are currently in the process of operationalizing changes to our branded mobile apps offering to comply with Apple's recent changes to its terms of service. These platform providers have broad discretion to change their terms and conditions at any time, with or without notice to application developers, and to interpret their respective terms and conditions in a manner that limits, eliminates or otherwise interferes with our ability to distribute our mobile applications through their platforms. If Apple or Google took any of these steps to limit or otherwise interfere with our business, our business, financial condition and results of operations could be adversely affected. In addition, if we or our customers are unable to respond timely to these platform providers' changes in their terms and conditions, our business may be harmed. For example, in the third quarter of 2018, we experienced a delay in the deployment of certain branded mobile apps, which had an adverse impact on our financial results.

We also depend on our partner ecosystem to create applications that will integrate with our platform. This presents certain risks to our business, including:

- security standards for our APIs could limit integration possibilities for our apps with partners' products; these applications may not meet the same quality standards that we apply to our own development efforts (including, among other things, data and privacy protections), and to the extent they contain bugs or defects, they may create disruptions in our customers' use of our platform or adversely affect our brand;
- we do not currently provide substantive support for software applications developed by our partner ecosystem, and users may be left without adequate support and potentially cease using our platform if our partners do not provide adequate support for these applications;
- our partners may not possess the appropriate intellectual property rights to develop and share their applications; our relationship with our partners may change, particularly those partners who contribute or who have contributed more significantly to our revenue or demand for our platform, which could adversely affect our revenue and our results of operations;
- some of our partners may use the insight or access to data that they gain from integrating with our software and from information publicly available to develop competing products or product features; and

our partners may establish relationships with, or functionality to offer to, our customers that diminish or eliminate the need or desire for our API platform.

Since many of these risks are not within our control, any new standards or requirements by these third-party developers or platforms could adversely affect our business, thereby reducing our revenue or increase our operating costs and adversely affecting our growth prospects.

We have in the past completed acquisitions, and we may in the future acquire or invest in companies. Such acquisitions and investments divert our management's attention and may in some cases result in additional dilution to our stockholders. In addition, we may be unable to integrate the acquired businesses and technologies successfully or achieve the expected benefits of such acquisitions.

We have in the past acquired companies, including our acquisition of HealCode LLC in 2016, Lymber Wellness, Inc. in 2017 and FitMetrix and Booker in 2018, and we may in the future evaluate and consider potential strategic transactions, including acquisitions of, or investments in, businesses, technologies, services, products and other assets in the future. We also may enter into relationships with other businesses to expand our platform, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing or investments in other companies.

Any acquisition, investment or business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, their software is not easily adapted to work with our platform or we have difficulty retaining the customers of any acquired business due to changes in ownership, management or otherwise. The pursuit of potential acquisitions, whether or not they are consummated, may also disrupt our business, divert our resources and require significant management attention that would otherwise be available for development of our existing business. Moreover, the anticipated benefits of any acquisition, investment or business relationship may not be realized and/or we may be exposed to unknown risks or liabilities.

Negotiating these transactions can be time-consuming, difficult and expensive, and our ability to complete these transactions may be subject to approvals that are beyond our control. Consequently, these transactions, even if announced, may not be completed. For one or more of these transactions, we may:

- issue additional equity securities that would dilute our existing stockholders;
- use cash that we may need in the future to operate our business;
- incur large charges or substantial liabilities, whether known or unknown, associated with the acquisition;
- encounter difficulties integrating and maintaining relationships with customers and partners of the acquired business;
- encounter difficulties cross-selling the services of the acquired company to our existing customers;
- encounter difficulties incorporating acquired technologies and rights into our platform, providing access and rights to our internal systems, integrating the acquired companies' accounting, management information and human resources systems, and maintaining quality and security standards consistent with our reputation and brand;
- incur debt on terms unfavorable to us or that we are unable to repay;
- encounter difficulties retaining key employees of the acquired company, integrating diverse software codes or business cultures or coordinating organizations that are geographically diverse and that have different business cultures;
- incur unanticipated expenses and delays in completing acquired development projects and technology integration and upgrades;
- assume unknown material liabilities of acquired companies;
- encounter difficulties accurately projecting the revenue and costs structure associated with acquired companies;
- incur impairment charges related to potential write-downs of acquired assets or goodwill;

incur acquisition-related costs, which would be recognized as current period expenses; and become subject to adverse tax consequences, substantial depreciation or deferred compensation charges.

We have experienced many of these challenges with respect to our recent acquisition of Booker, including challenges with respect to the integration of Booker's sales support systems and sales personnel with our own. Mergers and acquisitions are inherently risky and subject to many factors outside of our control, and no assurance can be given that our previous or future acquisitions will be successful and will not result in a material adverse effect on our business operations and financial results.

Real or perceived inaccuracies in our key, user and other metrics may harm our reputation and negatively affect our business.

The numbers for certain of our key, user and other metrics, including, among others, active consumers, registered users of our applications and number of wellness practitioners employed by our customers, are calculated using internal company data based on the activity of customer and consumer accounts. While these numbers are based on what we believe to be reasonable estimates for the applicable period of measurement, there are inherent challenges in measuring usage of our platform, usage of specific features of our platform, and user information across large online and mobile populations around the world. For example, we estimate that approximately 58.1 million active consumers used our platform during the two years ended September 30, 2018. In calculating this number, we have attempted to avoid duplicative counting of consumers by identifying consumers who may have used our platform through different customers. However, in certain cases, a single consumer may have transacted with multiple customers under slightly different names, in which case we may have counted the same consumer more than once. Given the challenges inherent in identifying whether a single consumer has engaged in transactions on our platform under different names, we do not have a reliable way of identifying the precise number of consumers using our platform. We are continuing to invest in our systems and controls to improve the precision and reliability of our metrics. If third parties, including investors and analysts, do not perceive our metrics to be accurate, or if we discover material inaccuracies in our metrics, we may be subject to liability and our reputation may be harmed, which could negatively affect our business and financial results.

Our international sales and operations subject us to additional risks that can adversely affect our business, operating results and financial condition.

In the nine months ended September 30, 2018 and 2017, we derived 19% and 19%, respectively, of our revenue from customers located outside of the United States. We are continuing to expand our international operations as part of our growth strategy. We currently have sales and customer support operations in the United States, the United Kingdom and Australia. Our sales organization outside the United States is substantially smaller than our sales organization in the United States. We believe our ability to convince new customers to subscribe to our platform or to convince existing customers to renew or expand their use of our platform is directly correlated to the level of engagement we obtain with the customer. To the extent we are unable to effectively engage with non-U.S. customers due to our limited sales force capacity, we may be unable to effectively grow in international markets.

Our international operations subject us to a variety of additional risks and challenges, including:

- compliance with foreign privacy, information security and data protection laws and regulations and the risks and costs of non-compliance;
- differing technical standards, existing or future regulatory and certification requirements and required features and functionality;
- requirements or customer requests for localized software and licensing programs, and localized language support;
- increased management, travel, infrastructure and legal compliance costs associated with having international operations;
- uncertainty regarding the expected departure of the United Kingdom from the European Union;
- increased financial accounting and reporting burdens and complexities;
- longer payment cycles and difficulties in enforcing contracts, collecting accounts receivable or satisfying revenue recognition criteria, especially in emerging markets;
- requirements or preferences for domestic products;

economic conditions in each country or region and general economic uncertainty around the world;

57

- compliance with laws and regulations for foreign operations, including anti-bribery laws (such as the U.S. Foreign Corrupt Practices Act of 1977, as amended (the “FCPA”), the U.S. Travel Act, and the U.K. Bribery Act 2010), import and export control laws, tariffs, trade barriers, economic sanctions and other regulatory or contractual limitations on our ability to sell our platform in certain foreign markets, and the risks and costs of non-compliance;
- heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact our financial results and result in restatements of our consolidated financial statements;
- fluctuations in currency exchange rates and related effect on our operating results;
- difficulties in repatriating or transferring funds from or converting currencies in certain countries;
- communication and integration problems related to entering new markets with different languages, cultures and political systems;
- differing labor standards, including restrictions related to, and the increased cost of, terminating employees in some countries;
- the need or customer requests for localized language support;
- reduced protection for intellectual property rights in some countries and practical difficulties of enforcing rights abroad; and
- compliance with the laws of numerous foreign taxing jurisdictions, including withholding obligations, and overlapping of different tax regimes.

Any of these risks could adversely affect our international operations, reduce our international revenue or increase our operating costs, adversely affecting our business, operating results, financial condition and growth prospects.

Compliance with laws and regulations applicable to our international operations substantially increases our cost of doing business in foreign jurisdictions. We may be unable to keep current with changes in government requirements as they change from time to time. Failure to comply with these regulations could have adverse effects on our business. In many foreign countries, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. or other regulations applicable to us. Although we have implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors, partners and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, partners, or agents could result in delays in revenue recognition, financial reporting misstatements, enforcement actions, disgorgement of profits, fines, civil and criminal penalties, damages, injunctions, other collateral consequences, or the prohibition of the importation or exportation of our platform and services and could adversely affect our business and results of operations.

We are subject to anti-corruption and anti-money laundering laws with respect to our operations and non-compliance with such laws can subject us to criminal and/or civil liability and harm our business.

We are subject to the FCPA, the U.S. domestic bribery statute contained in 18 U.S.C. § 201, the U.S. Travel Act, the USA PATRIOT Act, the U.K. Bribery Act 2010 and Proceeds of Crime Act 2002, and possibly other anti-bribery and anti-money laundering laws in countries in which we conduct activities. Anti-corruption laws are interpreted broadly and prohibit companies and their employees and third-party intermediaries from authorizing, offering, or providing, directly or indirectly, improper payments or benefits to recipients in the public or private sector. We use third-party representatives to sell our products and services abroad. In addition, as we increase our international sales and business, we may engage with additional business partners and third-party intermediaries to sell our products and services abroad and to obtain necessary permits, licenses and other regulatory approvals. We or our third-party intermediaries may have direct or indirect interactions with officials and employees of government agencies or state-owned or affiliated entities. We can be held liable for the corrupt or other illegal activities of these third-party intermediaries, our employees, representatives, contractors, partners and agents, even if we do not explicitly authorize such activities.

Noncompliance with anti-corruption and anti-money laundering laws could subject us to whistleblower complaints, investigations, sanctions, settlements, prosecution, other enforcement actions, disgorgement of profits, significant fines, damages, other civil and criminal penalties or injunctions, suspension and/or debarment from contracting with certain persons, the loss of export privileges, reputational harm, adverse media coverage and other collateral consequences. If any subpoenas or investigations are launched, or governmental or other sanctions are imposed, or if we do not prevail in any possible civil or criminal litigation, our business, results of operations and financial condition could be materially harmed. In addition, responding to any action will likely result in a materially significant diversion of management's attention and resources and significant defense costs and other professional fees. Enforcement actions and sanctions could further harm our business, results of operations and financial condition.

Certain of our operating results and financial metrics may be difficult to predict as a result of seasonality.

We believe there are significant seasonal factors that may cause us to record higher revenue in some quarters compared with others. We believe this variability is largely due to our focus on the fitness, beauty and wellness services industries, as many of our customers experience an increase in demand for their services in the first quarter of each year due to their clients becoming more motivated to pursue health and fitness goals in the new year. Our rapid growth rate over the last couple years may have made seasonal fluctuations more difficult to detect. In addition, as we attempt to expand the number of our customers and consumers, we may see changes to this pattern of seasonality. If our rate of growth slows over time, seasonal or cyclical variations in our operations may become more pronounced, and our business, results of operations and financial position may be adversely affected.

Our business and growth depend in part on the success of our strategic relationships with third parties, including payments partners, API platform partners and technology partners.

We depend on, and anticipate that we will continue to depend on, various third-party relationships in order to sustain and grow our business. We are highly dependent upon partners for certain critical features and functionality of our platform, including data centers and third-party payment processors supporting our payments platform. Failure of these or any other technology providers to maintain, support or secure their technology platforms in general, and our integrations in particular, or errors or defects in their technology, could materially and adversely impact our relationship with our customers, damage our reputation and brand, and harm our business and operating results. Any loss of the right to use any of this hardware or software could result in delays or difficulties in our ability to provide our platform until equivalent technology is either developed by us or, if available, identified, obtained and integrated. Identifying, negotiating and documenting relationships with strategic third parties such as payments partners, API partners and technology partners requires significant time and resources. In addition, integrating third-party technology is complex, costly and time-consuming. Our agreements with these partners are typically limited in duration, non-exclusive and do not prohibit them from working with our competitors or from offering competing services. Our competitors may be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our platform. In addition, our partners could develop competing products or services.

Our third-party partners may also suffer disruptions or weakness in their businesses unrelated to the relationships with us that could cause declines in their business performance. Such occurrences could be harmful to our financial results and cause our stock price to decline.

If we are unsuccessful in establishing or maintaining our relationships with these strategic third parties, our ability to compete in the marketplace or to grow our revenue could be impaired and our operating results could suffer. Even if we are successful, we cannot assure you that these relationships will result in improved operating results.

We depend and rely upon SaaS technologies from third parties and on technology systems and electronic communication networks that are supplied and managed by third parties to operate our business, and interruptions or performance problems with these technologies may adversely affect our business and operating results.

We rely heavily on hosted SaaS applications from third parties in order to operate critical functions of our business, including sales automation and pipeline management, billing and order management, customer support, access to our API, IT support, enterprise resource planning, payroll and financial accounting services. If these services become unavailable due to extended outages or interruptions, security vulnerabilities or cyber-attacks, including prolonged

denial-of-service attacks, or because they are no longer available on commercially reasonable terms, our expenses could increase, our ability to manage finances could be interrupted and our processes for managing sales of our platform and supporting and communicating with our customers could be

impaired until equivalent services, if available, are identified, obtained and implemented, all of which could adversely affect our business.

Our ability to provide services and solutions to our customers also depends on our ability to communicate with our customers through the public Internet and electronic networks that are owned and operated by third parties. In addition, in order to provide services on-demand and promptly, our computer equipment and network servers must be functional 24 hours per day, which requires access to telecommunications facilities managed by third parties and the availability of electricity, which we do not control. A severe disruption of one or more of these networks, including as a result of utility or third-party system interruptions, could impair our ability to process information, which could impede our ability to provide services to our customers, harm our reputation, result in a loss of customers and adversely affect our business and operating results.

We are subject to risks related to litigation, including, among others, intellectual property, commercial and employment claims and regulatory disputes.

From time to time we may become involved in legal proceedings or be subject to claims, lawsuits (whether class actions or individual lawsuits), government investigations and other proceedings involving alleged infringement of third-party patents and other intellectual property rights, or commercial, corporate and securities, privacy, accessibility, marketing and communications practices, labor and employment, wage and hour and other matters. Our future success depends in part on not infringing upon the intellectual property rights of others. From time to time, we may receive claims from third parties, including our competitors that our platform and underlying technology infringe or violate a third-party's intellectual property rights, and we may be found to be infringing upon such rights. Our exposure to risks associated with various claims, including the use of intellectual property, may be increased as a result of acquisitions of other companies. For example, we may have a lower level of visibility into the development process with respect to intellectual property or the care taken to safeguard against infringement risks with respect to the acquired company or technology. In addition, third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to our acquisitions. We may be unaware of the intellectual property rights of others that may cover some or all of our technology. Any claims or litigation could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, prevent us from offering our platform, or require that we comply with other unfavorable terms. We may also be obligated to indemnify our customers or business partners in connection with any such litigation and to obtain licenses, modify our platform or refund subscription fees, which could further exhaust our resources. In addition, we may incur substantial costs to resolve claims or litigation, whether or not successfully asserted against us, which could include payment of significant settlement, royalty or license fees, modification of our platform or refunds to customers of subscription fees. Even if we were to prevail in the event of claims or litigation against us, such claims or litigation could be costly and time-consuming and divert the attention of our management and other employees from our business operations.

Our use of "open source" software could adversely affect our ability to sell our platform and subject us to possible litigation.

We use open source software in our platform and expect to continue to use open source software in the future. We may face claims from others claiming ownership of, or seeking to enforce the terms of, an open source license, including by demanding release of the open source software, derivative works or our proprietary source code that was developed using such software. These claims could also result in litigation, require us to purchase a costly license or require us to devote additional research and development resources to change our platform, any of which would have a negative effect on our business and operating results. In addition, if the license terms for the open source software we utilize change, we may be forced to reengineer our platform or incur additional costs. Although we have implemented policies to regulate the use and incorporation of open source software into our platform, we cannot be certain that we have not incorporated open source software in our platform in a manner that is inconsistent with such policies.

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

Our success and ability to compete depend in part upon our intellectual property. While we currently have five issued patents and seventeen pending patent applications, our existing patents (four of which were acquired via our Booker acquisition) and any patents issued in the future may not provide us with competitive advantages or may be successfully challenged by third parties. In addition, there is no guarantee that our patent applications will result in issued patents. We primarily rely on copyright, trade secret and trademark laws, trade secret protection and confidentiality or license agreements with our employees, customers, partners and others to protect our intellectual property rights. However, the steps we take to protect our intellectual property rights may be inadequate.

To protect our intellectual property rights, we may be required to spend significant resources to monitor and protect these rights. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming and distracting to management, and could result in the impairment or loss of portions of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability of our intellectual property rights. Our failure to secure, protect and enforce our intellectual property rights could adversely affect our brand and adversely impact our business.

If our goodwill or intangible assets become impaired, we may be required to record a significant charge to earnings, which could seriously harm our operating results.

Under U.S. generally accepted accounting principles (“GAAP”), we review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. As of September 30, 2018, we had recorded a total of \$111.5 million of goodwill which is not being amortized and we have recorded \$69.3 million in net intangible assets related to our acquisitions and internally developed software which is being amortized over 2 to 10 years. An adverse change in market conditions, particularly if such change has the effect of changing one of our critical assumptions or estimates, could result in a change to the estimation of fair value that could result in an impairment charge to our goodwill or intangible assets. Any such material charges may seriously harm our business.

We may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs. We have funded our operations since inception primarily through equity financings, convertible senior notes, loan facilities, financing agreements for software and license maintenance and subscription payments by our customers for use of our platform. For instance, in June 2018, we offered and issued \$310,500,000 aggregate principal amount of 0.375% Convertible Senior Notes due 2023 (the “Notes”), including the initial purchasers’ exercise in full of their option to purchase an additional \$40,500,000 principal amount of the Notes. In May 2017, we also completed a follow-on public offering in which we issued and sold 5,060,000 shares of our Class A common stock at a public offering price of \$27.95 per share before underwriting discounts. In the future, we intend to continue to make investments to support our business growth, and we may require additional capital to respond to business opportunities, challenges, acquisitions, or unforeseen circumstances. We may not be able to timely secure additional debt or equity financing on favorable terms, or at all. Any debt financing obtained by us could involve restrictive covenants relating to financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. Depending on the treatment of the currently outstanding Notes or in the event that we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our Class A common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to grow or support our business and to respond to business challenges could be significantly limited.

Our loan agreement contains operating and financial covenants that restrict our business and financing activities. Borrowings under our loan agreement with Silicon Valley Bank are secured by substantially all of our assets, including our intellectual property. In addition, borrowings under our loan agreement are based on a percentage of our monthly recurring revenue for the prior months, up to \$20.0 million, with an accordion feature that allows for additional borrowings under our loan agreement in an aggregate amount of \$20.0 million, upon our request and subject to certain conditions. If our revenue declines, our ability to draw under the loan agreement could be adversely affected or if we were to draw under the loan agreement, a decline in our revenue could force us to repay all or a portion of the outstanding loan earlier than we may have originally anticipated.

Our loan agreement also restricts our ability to, among other things:

- sell or otherwise dispose of our assets;
- make material changes in our business;
- enter into a transaction in which stockholders who were not stockholders immediately prior to such transaction own more than 40% of our voting stock after giving effect to such transaction;

- consolidate, merge with, or acquire other entities;
- incur additional indebtedness;
- create liens on our assets;
- pay dividends or make other distributions on our capital stock;

make investments;
enter into transactions with affiliates; and
pay off or redeem subordinated indebtedness.

These restrictions are subject to certain exceptions. The operating and financial restrictions and covenants in the loan agreement, as well as any future financing agreements that we may enter into, could restrict our ability to finance our operations and to engage in, expand or otherwise pursue business activities and strategies that we or our stockholders may consider beneficial. Our ability to comply with these covenants may be affected by events beyond our control, and future breaches of any of these covenants could result in a default under the loan agreement.

The loan agreement also contains customary events of default, subject to cure periods for certain defaults, including, among others, payment defaults, covenant defaults, the occurrence of a material adverse change in our business, defaults relating to certain legal processes affecting our assets or business, insolvency and bankruptcy defaults, cross-defaults to other material indebtedness, material judgment defaults and material misrepresentations. Future defaults, if not waived, could cause all of the outstanding indebtedness under our loan agreement to become immediately due and payable and would permit Silicon Valley Bank to terminate all commitments to extend further credit and exercise remedies against the collateral in which we granted Silicon Valley Bank a security interest.

If we do not have or are unable to generate sufficient cash available to repay our debt obligations when they become due and payable, either upon maturity or in the event of a default, we may not be able to obtain additional debt or equity financing on favorable terms, if at all. This could materially and adversely affect our liquidity and financial condition and our ability to operate and continue our business as a going concern.

We face exposure to foreign currency exchange rate fluctuations.

We conduct transactions in currencies other than the U.S. dollar. While we have primarily transacted with customers and vendors in U.S. dollars, we have transacted in foreign currencies for subscriptions to our platform and expect to significantly expand the number of transactions with customers for our platform that are denominated in foreign currencies in the future. As a result of such foreign currency exchange rate fluctuations, it could be more difficult to detect underlying trends in our business and results of operations. In addition, to the extent that fluctuations in currency exchange rates, including, any fluctuations resulting from uncertainties relating to the expected departure of the United Kingdom from the European Union, cause our results of operations to differ from our expectations or the expectations of our investors, the trading price of our Class A common stock could be adversely affected.

We do not currently maintain a program to hedge transactional exposures in foreign currencies. However, in the future, we may use derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place. Moreover, the use of hedging instruments may introduce additional risks if we are unable to structure effective hedges with such instruments.

We may be subject to additional tax liabilities in connection with our operations or due to future legislation, each of which could materially impact our financial position and results of operation.

We are subject to federal and state income, sales, use, value added and other taxes in the United States and other countries in which we conduct business, and such laws and rates vary by jurisdiction. We do not collect sales and use, value added and similar taxes in all jurisdictions in which we have sales, based on our belief that such taxes are not applicable. Certain jurisdictions in which we do not collect sales, use, value added or other taxes on our sales may assert that such taxes are applicable, which could result in tax assessments, penalties and interest, and we may be required to collect such taxes in the future.

Significant judgment is required in determining our worldwide provision for income taxes. We generally conduct our international operations through wholly owned subsidiaries and report our taxable income in various jurisdictions worldwide based upon our business operations in those jurisdictions. Our intercompany relationships are subject to complex transfer pricing regulations administered by taxing authorities in various jurisdictions. These determinations are highly complex and require detailed analysis of the available information and applicable statutes and regulatory materials. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain.

Although we believe our tax practices and provisions are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical tax practices, provisions and accruals. If we receive an adverse ruling as a result of an audit, or we unilaterally determine that we have misinterpreted provisions of the tax regulations to which we are subject, there could be a material effect on our tax provision, net income or cash flows in the period or periods for which that determination is made, which could materially impact our financial results. Further, any changes in the taxation of our activities, including recent changes in U.S. tax laws, may increase our worldwide effective tax rate and adversely affect our financial position and results of operations. In addition, liabilities associated with taxes are often subject to an extended or indefinite statute of limitations period. Therefore, we may be subject to additional tax liability (including penalties and interest) for a particular year for extended periods of time.

Our ability to use our net operating losses to offset future taxable income may be subject to certain limitations. As of December 31, 2017, we had federal and state net operating loss carryforwards (“NOLs”), of \$118.0 million and \$103.0 million, respectively, due to prior period losses, which, subject to the following discussion, are generally available to be carried forward to offset our future taxable income, if any, until such NOLs are used or expire. Our federal NOLs begin to expire in the year ending December 31, 2025, and our state NOLs started to expire in 2016 for the earliest net operating loss layers. In general, under Section 382 of the U.S. Internal Revenue Code of 1986, as amended (the “Code”), a corporation that undergoes an “ownership change” is subject to limitations on its ability to utilize its NOLs to offset future taxable income. Similar rules may apply under state tax laws. During the year ended December 31, 2015, we completed an analysis under Section 382 of the Code through December 31, 2014, and determined that we experienced multiple ownership changes during this period which will limit future utilization of NOL carryforwards. U.S. federal NOLs of approximately \$430,000 are expected to expire due to limitations under Section 382 and, as such, have not been reflected in the NOL carryforward above. Future changes in our stock ownership, some of which are outside of our control, could result in additional ownership changes under Section 382 of the Code. Furthermore, our ability to utilize NOLs of companies that we have acquired or may acquire in the future may be subject to limitations. There is also a risk that due to regulatory changes, such as suspensions on the use of NOLs, or other unforeseen reasons, our existing NOLs could expire or otherwise be unavailable to offset future income tax liabilities. For these reasons, we may not be able to realize a tax benefit from the use of our NOLs, whether or not we attain profitability.

Changes in laws and regulations related to the Internet or changes in the Internet infrastructure itself may diminish the demand for our platform, and could have a negative impact on our business.

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication and business applications. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting the use of the Internet as a commercial medium. Changes in these laws or regulations could require us to modify our platform in order to comply with these changes. In addition, government agencies or private organizations have imposed and may impose additional taxes, fees or other charges for accessing the Internet or commerce conducted via the Internet. These laws or charges could limit the growth of Internet-related commerce or communications generally, or result in reductions in the demand for Internet-based platforms and services such as ours. In addition, the use of the Internet as a business tool could be adversely affected due to delays in the development or adoption of new standards and protocols to handle increased demands of Internet activity, security, reliability, cost, ease-of-use, accessibility and quality of service. The performance of the Internet and its acceptance as a business tool has been adversely affected 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 the use of the Internet is adversely affected by these issues, demand for our platform could decline.

Catastrophic events may disrupt our business.

Our corporate headquarters are located in San Luis Obispo, California, and we utilize data centers that are located in North America. Key features and functionality of our platform are enabled by third parties that are headquartered in California and operate or utilize data centers in the United States. Additionally, we rely on our network and third-party infrastructure and enterprise applications, internal technology systems, and our website for our

development, marketing, operational support, hosted services and sales activities. The west coast of the United States contains active earthquake zones, both Northern and Southern California have experienced devastating wildfires, and Southern California has recently experienced significant flooding. In addition, the Diablo Canyon nuclear power plant is located a short distance from San Luis Obispo. In the event of a major earthquake, hurricane or other natural disaster, or a catastrophic event such as a nuclear disaster, fire, power loss, telecommunications failure, cyber-attack, war or terrorist attack, we may be unable to continue our operations and may endure system interruptions, reputational harm, delays in our app development, lengthy interruptions in our platform, breaches of data security or data integrity and loss of critical data, all of which could have an adverse effect on our future operating results.

We are subject to governmental economic sanctions and export and import controls that could impair our ability to compete in international markets or subject us to liability if we are not in compliance with applicable laws. As a U.S. company, we are subject to U.S. export control and economic sanctions laws and regulations, and we are required to export our technology, software, products and services in compliance with those laws and regulations, including the U.S. Export Administration Regulations and economic embargo and trade sanction programs administered by the Treasury Department's Office of Foreign Assets Control. U.S. economic sanctions and export control laws and regulations prohibit the shipment of certain products and services to countries, governments and persons targeted by U.S. sanctions. While we are currently taking precautions to prevent doing any business, directly or indirectly, with countries, governments and persons targeted by U.S. sanctions and to ensure that our business management software is not exported or used by countries, governments and persons targeted by U.S. sanctions, such measures may be circumvented.

Furthermore, if we export our technology, hardware or software, the exports may require authorizations, including a license, a license exception or other appropriate government authorization. Complying with export control and sanctions regulations for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities. Failure to comply with export control and sanctions regulations for a particular sale may expose us to government investigations and penalties, which could have an adverse effect on our business, operating results and financial condition.

If we are found to be in violation of U.S. sanctions or export control laws, it could result in fines or penalties for us and for individuals, including civil penalties of up to \$250,000 or twice the value of the transaction, whichever is greater, per violation, and in the event of conviction for a criminal violation for willful and knowing violations, fines of up to \$1 million and possible incarceration for those responsible could be imposed against employees and managers. In addition, we may lose our export or import privileges and suffer reputational harm.

In addition, various countries regulate the import of certain encryption technology, including imposing import permitting and licensing requirements, and have enacted laws that could limit our ability to offer our platform or distribute our platform or could limit our customers' ability to implement our platform in those countries. Changes in our platform or future changes in export and import regulations may create delays in the introduction of our platform in international markets or prevent our customers with international operations from deploying our platform globally. Any change in export or import regulations, economic sanctions or related legislation, or change in the countries, governments, persons, or technologies targeted by such regulations, could result in decreased use of our platform by, or in our decreased ability to export or sell our platform to, existing or potential customers with international operations. Any decreased use of our platform or limitation on our ability to export or sell our platform would likely adversely affect our business operations and financial results.

We have incurred substantial indebtedness that may decrease our business flexibility, access to capital and/or increase our borrowing costs, and we may still incur substantially more debt, which may adversely affect our operations and financial results.

As of September 30, 2018, we had \$310.5 million (undiscounted) principal amount of indebtedness under our Notes. Our indebtedness may:

- limit our ability to borrow additional funds for working capital, capital expenditures, acquisitions or other general business purposes;
- limit our ability to use our cash flow or obtain additional financing for future working capital, capital expenditures, acquisitions or other general business purposes;
- require us to use a substantial portion of our cash flow from operations to make debt service payments;
- limit our flexibility to plan for, or react to, changes in our business and industry;
- place us at a competitive disadvantage compared to our less leveraged competitors; and
- increase our vulnerability to the impact of adverse economic and industry conditions.

Risks Related to Our Notes

We may not have the ability to raise the funds necessary to settle conversions of the Notes in cash or to repurchase the Notes upon a fundamental change, and our future debt may contain limitations on our ability to pay cash upon conversion or repurchase of the Notes.

Subject to certain conditions, holders of the Notes may require us to repurchase for cash all or a portion of their Notes upon the occurrence of a fundamental change (as defined in the indenture governing the Notes) at a repurchase price equal to 100% of

the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any, to, but excluding, the fundamental change repurchase date. In addition, if a make-whole fundamental change (as defined in the indenture for the Notes) occurs prior to the maturity date of the Notes, we will in some cases be required to increase the conversion rate for a holder that elects to convert its Notes in connection with such make-whole fundamental change. Upon a conversion of the Notes, unless we elect to deliver solely shares of our Class A common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefor or pay cash with respect to Notes being converted.

In addition, our ability to repurchase or to pay cash upon conversion of the Notes may be limited by law, regulatory authority or agreements governing our future indebtedness. Our failure to repurchase the Notes at a time when the repurchase is required by the indenture governing the Notes or to pay cash upon conversion of the Notes as required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness. If the payment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or to pay cash upon conversion of the Notes.

Servicing our debt requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the amounts payable under the Notes, and any future borrowings under our senior secured credit facility, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations.

We may still incur substantially more debt or take other actions that would diminish our ability to make payments on the Notes when due.

We and our subsidiaries may incur substantial additional debt in the future, subject to the restrictions contained in our debt instruments, some of which may be secured debt. We are not restricted under the terms of the indenture governing the Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that could have the effect of diminishing our ability to make payments on the Notes when due. Furthermore, the indenture prohibits us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the Notes and the indenture. These and other provisions in the indenture could deter or prevent a third party from acquiring us even when the acquisition may be favorable to holders of the Notes.

The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the Notes is triggered, holders of the Notes will be entitled to convert the Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than by paying cash in lieu of delivering any fractional share), we may settle all or a portion of our conversion obligation in cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The capped call transactions may affect the value of the Notes and our Class A common stock.

In connection with the Notes, we entered into capped call transactions with certain financial institutions (“the option counterparties”). The capped call transactions are expected generally to reduce the potential dilution upon any conversion of the Notes and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of the Notes, with such reduction and/or offset subject to a cap.

In connection with establishing their initial hedges of the capped call transactions, the option counterparties and/or their respective affiliates purchased shares of our Class A common stock and/or entered into various derivative transactions with respect to our Class A common stock. This activity could have increased (or reduced the size of any decrease in) the market price of our Class A common stock or the Notes at that time.

In addition, the option counterparties and/or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our Class A common stock and/or purchasing or selling our Class A common

stock in secondary market transactions (and are likely to do so during any observation period related to a conversion of notes or following any repurchase of notes by us on any fundamental change repurchase date or otherwise). This activity could also cause or avoid an increase or a decrease in the price of our Class A common stock or the Notes. The potential effect, if any, of these transactions and activities on the price of our Class A common stock or the Notes will depend in part on market conditions and cannot be ascertained at this time. Any of these activities could adversely affect the value of our Class A common stock.

Conversion of the Notes will dilute the ownership interest of existing stockholders, including holders who had previously converted their Notes, or may otherwise depress the price of our Class A common stock.

The conversion of some or all of the Notes will dilute the ownership interests of existing stockholders to the extent we deliver shares of our Class A common stock upon conversion of any of the Notes. The Notes may become in the future convertible at the option of their holders prior to their scheduled terms under certain circumstances. Any sales in the public market of the Class A common stock issuable upon such conversion could adversely affect prevailing market prices of our Class A common stock. In addition, the existence of the Notes may encourage short selling by market participants because the conversion of the Notes could be used to satisfy short positions, or anticipated conversion of the Notes into shares of our Class A common stock could depress the price of our Class A common stock.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, (“ASC 470-20”). Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer’s economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders’ equity on our Condensed Consolidated Balance Sheet, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. We will report larger net losses or lower net income in our financial results because ASC 470-20 will require interest to include both the current period’s amortization of the debt discount and the instrument’s non-convertible coupon interest, which could adversely affect our reported or future financial results, the trading price of our Class A common stock and the trading price of the Notes.

In addition, under certain circumstances, convertible debt instruments (such as the Notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the Notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the Notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Notes, then our diluted earnings per share would be adversely affected.

Risks Related to Ownership of Our Class A Common Stock

The dual class structure of our common stock has the effect of allowing those stockholders who held our capital stock prior to the completion of our initial public offering, including our executive officers, employees and directors and their affiliates, to limit your ability to influence the outcome of important transactions, including a change in control.

Our Class B common stock has ten votes per share, and our Class A common stock has one vote per share.

Stockholders who held shares of our Class B common stock as of September 30, 2018, including, among others, our executive officers, employees and directors and their respective affiliates, collectively held approximately 36% of the voting power of our outstanding capital stock as of such date. Because of the ten-to-one voting ratio between our Class B common stock and Class A common stock, the holders of our Class B common stock will collectively continue to have significant influence over our management and affairs and over all matters requiring stockholder approval. These holders of our Class B common stock may have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. The effect of this dual class structure may have the effect of delaying, preventing or deterring a change in control of our company, could deprive our stockholders of an opportunity to receive a premium for their capital stock as part of a sale of our company and might ultimately affect the market price of our Class A common stock.

Significant individual holders of our Class B common stock include our Chairman and Chief Executive Officer, Richard Stollmeyer. If, for example, Mr. Stollmeyer retains a significant portion of his holdings of shares of our Class B common stock for an extended period of time, he could control a significant portion of the voting power of our capital stock for the foreseeable future. In addition, Mr. Stollmeyer holds an irrevocable proxy to vote certain shares of our Class A common stock and Class B common stock held by certain of our stockholders. As a board member, Mr. Stollmeyer owes a fiduciary duty to our stockholders and must act in good faith and in a manner he reasonably believes to be in the best interests of our stockholders. As a stockholder, Mr. Stollmeyer is entitled to vote his shares in his own interest, which may not always be in the interests of our stockholders generally.

Anti-takeover provisions contained in our amended and restated certificate of incorporation and amended and restated bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our amended and restated certificate of incorporation, amended and restated bylaws and Delaware law contain provisions which could have the effect of rendering more difficult, delaying or preventing an acquisition deemed undesirable by our board of directors. Among other things, our amended and restated certificate of incorporation and amended and restated bylaws include provisions:

- establishing a classified board of directors whose members serve staggered three-year terms;
- authorizing “blank check” preferred stock, which could be issued by our board of directors without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;
- controlling the procedures for the conduct and scheduling of board of directors and stockholder meetings; and
- authorizing two classes of common stock, as discussed above.

These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents certain stockholders holding more than 15% of our outstanding capital stock from engaging in certain business combinations without approval of the holders of at least two-thirds of our outstanding common stock not held by any such stockholder.

Any provision of our amended and restated certificate of incorporation, amended and restated bylaws or Delaware law that has the effect of delaying, preventing or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our capital stock, and could also affect the price that some investors are willing to pay for our Class A common stock.

An active trading market for our Class A common stock may not be sustained.

Our Class A common stock is listed on The NASDAQ Global Market under the symbol "MB." However, we cannot assure you that an active trading market for our Class A common stock will be sustained. Accordingly, we cannot assure you of the liquidity of any trading market, your ability to sell your shares of our Class A common stock when desired or the prices that you may obtain for your shares of our Class A common stock.

The market price of our Class A common stock may be volatile, and you could lose all or part of your investment.

Prior to our initial public offering, there had been no public market for shares of our Class A common stock. The market price of our Class A common stock since our initial public offering has been and may continue to be subject to wide fluctuations in response to various factors, some of which are beyond our control and may not be related to our operating performance. Factors that could cause fluctuations in the market price of our Class A common stock include the following:

- price and volume fluctuations in the overall stock market from time to time;
- volatility in the market prices and trading volumes of technology securities;
- changes in operating performance and stock market valuations of other technology companies generally or those in our industry in particular;
- announced or completed equity or debt transactions involving our securities;
- sales of shares of our Class A common stock by us or our stockholders;
- failure of securities analysts to maintain coverage of us, changes in financial estimates by securities analysts who follow us, or our failure to meet these estimates or the expectations of investors;
- the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections;
- announcements by us or our competitors of new products or services;
- the public's reaction to our press releases, other public announcements and filings with the SEC;
- rumors and market speculation involving us or other companies in our industry;
- actual or anticipated changes in our operating results or fluctuations in our operating results;
- actual or anticipated developments in our business, our competitors' businesses or the competitive landscape generally;
- litigation involving us, our industry or both, or investigations by regulators into our operations or those of our competitors;
- developments or disputes concerning our intellectual property or other proprietary rights;
- cybersecurity attacks or incidents;
- announced or completed acquisitions of businesses or technologies by us or our competitors;
- political, economic and regulatory developments in the United States or other geographies;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidelines, interpretations or principles;
- any significant change in our management; and
- general economic conditions and slow or negative growth of our markets.

In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

Future sales of shares of our Class A common stock in the public market, or the perception that such sales might occur, could depress the market price of our Class A common stock.

Sales of a substantial number of shares of our Class A common stock in the public market, or the perception that these sales might occur, could depress the market price of our Class A common stock and could impair our ability to raise capital through the sale of additional equity securities. As of September 30, 2018, we had 45.4 million shares of Class A common stock and 2.6 million shares of Class B common stock outstanding. All outstanding shares of Class A common stock are freely tradable without restrictions or further registration under the Securities Act of 1933, as amended (the "Securities Act"), except for any shares held by our affiliates as defined in Rule 144 under the Securities Act and subject in some cases to our insider trading policy.

In addition, shares of our capital stock (including those shares of our capital stock issued upon exercise of outstanding options to purchase shares of our Class A common stock and Class B common stock or upon settlement of outstanding restricted stock units) may be freely sold in the public market upon issuance and once vested, subject to other restrictions provided under the terms of the applicable plan and/or the award agreements, and except for any options or restricted stock units held by our affiliates and subject to our insider trading policy. Certain of our existing stockholders are also entitled under contracts providing for registration rights, to require us to file registration statements covering the sale of their shares or to include their shares in registration statements that we may file for ourselves or other stockholders. Any sales of securities by these stockholders, or the expectation that such sales may occur, could have a material adverse effect on the trading price of our Class A common stock and make it more difficult for you to sell shares of our Class A common stock.

The requirements of being a public company may strain our resources, divert management's attention and affect our ability to attract and retain qualified board members.

As a public company, we incur significant legal, financial, and other expenses that we did not incur as a private company. We are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and are required to comply with the applicable requirements of the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the listing requirements of the NASDAQ Stock Market, and other applicable securities rules and regulations and corporate governance requirements. Continuing to comply with these rules and regulations may increase our legal and financial compliance costs, make some activities more difficult, time-consuming or costly, and increase demand on our systems and resources. In addition, our management and personnel must divert attention from operational and other business concerns to devote time to these requirements, which could harm our business and results of operations. Although we have already hired additional employees to comply with these requirements, we may need to hire even more employees in the future, which would increase our costs and expenses.

Being a public company and these new rules and regulations have made it more expensive for us to maintain director and officer liability insurance, and in the future we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified executive officers and members of our board of directors, particularly to serve on our audit committee and compensation committee.

In addition, as a result of our disclosure obligations as a public company, we have reduced strategic flexibility and are under pressure to focus on short-term results, which may adversely impact our ability to achieve long-term profitability.

If our internal control over financial reporting is not effective, it may adversely affect investor confidence in our company and, as a result, the value of our Class A common stock could decline.

As a public company, we are required to design and maintain effective internal control over financial reporting and to report any material weaknesses in such internal controls. Section 404 of the Sarbanes-Oxley Act of 2002 requires that we assess the effectiveness of our internal control over financial reporting and furnish a report by management on the effectiveness of our internal control over financial reporting, which must be attested to, and reported on, by our independent registered public accounting firm. During such assessment, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective. As a result, we may need to undertake various actions, such as implementing new internal controls and

procedures and hiring accounting or internal audit staff. Our remediation efforts may not enable us to avoid a material weakness in the future. Moreover, in the event we make a significant acquisition, or a series of smaller acquisitions, such as our recent acquisitions of FitMetrix and Booker, we may face significant challenges in implementing the required processes and procedures to maintain effective internal controls over financial reporting with respect to the consolidated entities, including the acquired companies. As a result, our independent registered public accountants may decline or be unable to report on the effectiveness of our internal controls over financial reporting or may issue a qualified report in the future. This could

result in an adverse reaction in the financial markets due to investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements.

If material weaknesses or control deficiencies occur in the future, and we are unable to assert that our internal control over financial reporting is effective, or if our auditors are unable to attest to management's report on the effectiveness of our internal controls, we may be unable to report our financial results accurately or on a timely basis, which could cause our reported financial results to be materially misstated and result in the loss of investor confidence or delisting and cause the trading price of our Class A common stock to decline. As a result of such failures, we could also become subject to investigations by the stock exchange on which our securities are listed, the SEC, or other regulatory authorities, and become subject to litigation from investors and stockholders, which could harm our reputation, financial condition or divert financial and management resources from our core business.

If securities or industry analysts cease publishing research or reports about us, our business, our market or our competitors, or if they adversely change their recommendations regarding our Class A common stock, the market price of our Class A common stock and trading volume could decline.

The trading market for our Class A common stock is influenced by the research and reports that securities or industry analysts may publish about us, our business, our market or our competitors. If any of the analysts who cover us adversely change their recommendations regarding our Class A common stock or provide more favorable recommendations about our competitors, the market price of our Class A common stock would likely decline. If any of the analysts who cover us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause the market price of our Class A common stock and trading volume to decline.

We do not expect to declare any dividends on our Class A common stock in the foreseeable future so any returns will be limited to changes in the value of our Class A common stock.

We do not anticipate declaring any cash dividends on our Class A common stock in the foreseeable future. In addition, our existing loan agreement with Silicon Valley Bank imposes restrictions on our ability to pay dividends. Consequently, investors may need to rely on sales of our Class A common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase shares of our Class A common stock.

Item 6. Exhibits

Exhibit Number	Description	Incorporated by Reference		
		Form	File No.	Exhibit Filing Date
31.1*	<u>Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>			
31.2*	<u>Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>			
32.1**	<u>Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>			
32.2**	<u>Certification of Principal 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 Extension Schema Document			
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document			
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document			
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document			
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document			

*Filed herewith.

Furnished herewith. The certifications attached as Exhibit 32.1 and Exhibit 32.2 that accompany this Quarterly Report on Form 10-Q are deemed furnished and not filed with the Securities and Exchange Commission and are not **to be incorporated by reference into any filing of MINDBODY, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

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.

MINDBODY, INC.

Date: November 8, 2018 By: /s/ Richard Stollmeyer
Richard Stollmeyer
Chief Executive Officer
(Principal Executive Officer)

Date: November 8, 2018 By: /s/ Brett White
Brett White
Chief Financial Officer and Chief Operating Officer
(Principal Financial Officer)