CHANNELADVISOR CORP
Form 10-Q
August 04, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from to
Commission File Number 001-35940

CHANNELADVISOR CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	56-2257867 (I.R.S. Employer Identification No.)
2701 Aerial Center Parkway, Morrisville, NC (Address of principal executive offices)	27560 (Zip Code)

(919) 228-4700
(Registrant’s telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Securities Exchange Act of 1934.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ¨ No x

The number of outstanding shares of the registrant's common stock, par value $0.001 per share, as of the close of business on July 24, 2015 was 25,083,567.

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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements
ChannelAdvisor Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)

	June 30, 2015 (unaudited)	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$57,711	$68,366
Accounts receivable, net of allowance of $982 and $673 as of June 30, 2015 and December 31, 2014, respectively	16,405	14,619
Prepaid expenses and other current assets	6,885	4,940
Total current assets	81,001	87,925
Property and equipment, net	14,066	12,603
Goodwill	21,500	21,518
Intangible assets, net	3,617	4,083
Restricted cash	567	633
Other assets	659	285
Total assets	$121,410	$127,047
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$1,875	$564
Accrued expenses	8,520	7,292
Deferred revenue	18,886	16,840
Other current liabilities	2,510	2,563
Total current liabilities	31,791	27,259
Long-term capital leases, net of current portion	1,078	2,014
Other long-term liabilities	5,273	4,126
Total liabilities	38,142	33,399
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding as of June 30, 2015 and December 31, 2014	—	—
Common stock, $0.001 par value, 100,000,000 shares authorized, 25,079,887 and 24,915,510 shares issued and outstanding as of June 30, 2015 and December 31, 2014, respectively	25	25
Additional paid-in capital	234,291	228,370
Accumulated other comprehensive loss	(951)	(130)
Accumulated deficit	(150,097)	(134,617)
Total stockholders’ equity	83,268	93,648
Total liabilities and stockholders’ equity	$121,410	$127,047

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

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Operations
(in thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenue	$24,182	$20,770	$46,772	$40,108
Cost of revenue (excluding depreciation)	5,249	5,687	10,617	10,666
Depreciation - Cost of revenue	1,152	732	2,200	1,485
Gross profit	17,781	14,351	33,955	27,957
Operating expenses:				
Sales and marketing	13,553	14,240	28,911	27,880
Research and development	4,055	4,187	8,081	8,151
General and administrative	5,831	4,849	10,792	9,550
Depreciation and amortization	937	586	1,822	1,167
Total operating expenses	24,376	23,862	49,606	46,748
Loss from operations	(6,595)	(9,511)	(15,651)	(18,791)
Other income (expense):				
Interest expense, net	(38)	(47)	(82)	(102)
Other income, net	120	3	126	—
Total other income (expense)	82	(44)	44	(102)
Loss before income taxes	(6,513)	(9,555)	(15,607)	(18,893)
Income tax (benefit) expense	11	49	(127)	81
Net loss	$(6,524)	$(9,604)	$(15,480)	$(18,974)
Net loss per share:				
Basic and diluted	$(0.26)	$(0.39)	$(0.62)	$(0.78)
Weighted average common shares outstanding:				
Basic and diluted	25,017,823	24,602,089	24,974,378	24,393,260

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

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Comprehensive Loss
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net loss	$(6,524)	$(9,604)	$(15,480)	$(18,974)
Other comprehensive loss:				
Foreign currency translation adjustments	216	208	(821)	303
Total comprehensive loss	$(6,308)	$(9,396)	$(16,301)	$(18,671)

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

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statement of Changes in Stockholders' Equity
(in thousands, except share data)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance, December 31, 2014	24,915,510	$25	$228,370	$ (130)	$(134,617)	$93,648
Exercise of stock options and vesting of restricted stock units	217,936	—	307	—	—	307
Stock-based compensation expense	—	—	6,176	—	—	6,176
Statutory tax withholding related to net-share settlement of restricted stock units	(53,559)	—	(562)	—	—	(562)
Net loss	—	—	—	—	(15,480)	(15,480)
Foreign currency translation adjustments	—	—	—	(821)	—	(821)
Balance, June 30, 2015	25,079,887	$25	$234,291	$ (951)	$(150,097)	$83,268

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

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows
(in thousands)

	Six Months Ended June 30,			
	2015		2014	
Cash flows from operating activities				
Net loss	$(15,480	)	$(18,974	)
Adjustments to reconcile net loss to cash and cash equivalents used in operating activities:				
Depreciation and amortization	4,022		2,652	
Bad debt expense	785		741	
Stock-based compensation expense	6,176		2,767	
Other items, net	(80	)	112	
Changes in assets and liabilities:				
Accounts receivable	(2,228	)	380	
Prepaid expenses and other assets	(1,891	)	(890	)
Accounts payable and accrued expenses	757		(3,157	)
Deferred revenue	2,042		2,261	
Cash and cash equivalents used in operating activities	(5,897	)	(14,108	)
Cash flows from investing activities				
Purchases of property and equipment	(2,745	)	(5,324	)
Payment of internal-use software development costs	(92	)	(629	)
Cash and cash equivalents used in investing activities	(2,837	)	(5,953	)
Cash flows from financing activities				
Repayment of capital leases	(353	)	(734	)
Proceeds from exercise of stock options	307		1,285	
Payment of statutory tax withholding related to net-share settlement of restricted stock units	(562	)	—	
Cash and cash equivalents (used in) provided by financing activities	(608	)	551	
Effect of currency exchange rate changes on cash and cash equivalents	(1,313	)	222	
Net decrease in cash and cash equivalents	(10,655	)	(19,288	)
Cash and cash equivalents, beginning of period	68,366		104,406	
Cash and cash equivalents, end of period	$57,711		$85,118	
Supplemental disclosure of cash flow information				
Cash paid for interest	$38		$165	
Cash paid for income taxes, net	$243		$46	
Supplemental disclosure of noncash investing and financing activities				
Capital lease obligations entered into for the purchase of fixed assets	$—		$2,431	

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

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ChannelAdvisor Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

1. Description of the Business

ChannelAdvisor Corporation (“ChannelAdvisor” or the “Company”) was incorporated in the state of Delaware and capitalized in June 2001. The Company began operations in July 2001. ChannelAdvisor is a provider of software-as-a-service, or SaaS, solutions that allow retailers and manufacturers to integrate, manage and monitor their merchandise sales across hundreds of online channels. The Company is headquartered in Morrisville, North Carolina and has international offices in England, Ireland, Germany, Australia, Brazil and China.

2. Significant Accounting Policies

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Interim Condensed Consolidated Financial Information

The accompanying condensed consolidated financial statements and footnotes have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) as contained in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) for interim financial information. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of financial position, the results of operations, comprehensive loss, changes in stockholders’ equity and cash flows. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results for the full year or the results for any future periods. These unaudited interim financial statements should be read in conjunction with the audited financial statements and related footnotes for the year ended December 31, 2014, which are included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 26, 2015.

Reclassification

Certain prior period amounts included on the condensed consolidated statements of operations have been reclassified to conform to the current period’s presentation. In order to gain further clarity and understanding of its operating results, the Company will now present depreciation and amortization expense separately on the condensed consolidated statements of operations. Previously, depreciation and amortization expense was included in cost of revenue and operating expenses. These reclassifications had no effect on the Company's reported gross profit and net loss for the three and six months ended June 30, 2014.

The tables below summarize these reclassifications (in thousands):

	Three Months Ended June 30, 2014		
	As Previously Reported	Reclassification	As Reclassified
Cost of revenue (excluding depreciation)	$6,419	$(732)	$5,687
Depreciation - Cost of revenue	—	732	732
Sales and marketing	14,435	(195)	14,240
Research and development	4,262	(75)	4,187
General and administrative	5,165	(316)	4,849
Depreciation and amortization	—	586	586

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	Six Months Ended June 30, 2014		
	As Previously Reported	Reclassification	As Reclassified
Cost of revenue (excluding depreciation)	$12,151	$(1,485)	$10,666
Depreciation - Cost of revenue	—	1,485	1,485
Sales and marketing	28,266	(386)	27,880
Research and development	8,309	(158)	8,151
General and administrative	10,173	(623)	9,550
Depreciation and amortization	—	1,167	1,167

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which provides new guidance for revenue recognition. ASU 2014-09 provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. Entities have the option of using either a full retrospective or modified retrospective approach for the adoption of the standard. ASU 2014-09 will be effective for the Company beginning January 1, 2018. Early adoption is permitted for years beginning after December 31, 2016. The Company is currently evaluating the impact the adoption of ASU 2014-09 will have on its consolidated financial statements.

The Company has reviewed other new accounting pronouncements that were issued as of June 30, 2015 and does not believe that these pronouncements are applicable to the Company, or that they will have a material impact on its financial position or results of operations.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable allowance, the useful lives of long-lived assets and other intangible assets, income taxes and assumptions used for purposes of determining stock-based compensation, among others. Estimates and assumptions are also required to value assets acquired and liabilities assumed as well as contingent consideration, where applicable, in conjunction with business combinations. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable, the results of which form the basis for making judgments about the carrying value of assets and liabilities.

Revenue Recognition and Deferred Revenue

The majority of the Company’s revenue is derived from subscription fees paid by customers for access to and usage of the Company’s cloud-based SaaS platform for a specified period of time, which is typically one year. A portion of the subscription fee is typically fixed and is based on a specified minimum amount of gross merchandise value (“GMV”) that a customer expects to process through the Company’s platform over the contract term. The remaining portion of the subscription fee is variable and is based on a specified percentage of GMV processed through the Company’s platform in excess of the customer’s specified minimum amount. In addition, other sources of revenue consist primarily of implementation fees, which may include fees for providing launch assistance and training. Implementation services are provided at the customer's option and are not essential to the functionality of the Company's platform, nor is the customer required to purchase these services in order to access the Company's platform. The Company also generates revenue from fixed subscription fees from its Where to Buy solution. These contacts are generally one year in duration. The Company recognizes revenue when there is persuasive evidence of an arrangement, the service has been provided to the customer, the collection of the fee is reasonably assured and the amount of the fee to be paid by the customer is fixed or determinable. The Company’s contractual arrangements include performance, termination and cancellation provisions, but do not provide for refunds. Customers do not have the contractual right to take possession of the Company’s software at any time.

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The Company’s arrangements generally contain multiple elements comprised of subscription and implementation services. The Company evaluates each element in an arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company’s control. The Company’s implementation services are not sold separately from the subscription and there is no alternative use for them. As such, the Company has determined the implementation services do not have standalone value. Accordingly, subscription and implementation services are combined and recognized as a single unit of accounting.

The Company generally recognizes the fixed portion of subscription fees and implementation fees ratably over the contract term. Recognition begins when the customer has access to the Company’s platform or Where to Buy solution and transactions can be processed, provided all other revenue recognition criteria have been met. Some customers elect a managed-service solution and contract with the Company to manage some or all aspects of the Company’s SaaS solutions on the customer’s behalf for a specified period of time, which is typically one year. Under these managed-service arrangements, customer transactions cannot be processed through the Company’s platform until the completion of the implementation services. As such, revenue is contingent upon the Company’s completion of the implementation services and recognition commences when transactions can be processed on the Company’s platform, provided all other revenue recognition criteria have been satisfied. At that time, the Company recognizes a pro-rata portion of the fees earned since the inception of the arrangement. The balance of the fees is recognized ratably over the remaining contract term.

The Company recognizes the variable portion of subscription fee revenue in the period in which the related GMV is processed, provided all other revenue recognition criteria have been met.

Sales taxes collected from customers and remitted to government authorities are excluded from revenue.

Deferred revenue represents the unearned portion of fixed subscription fees and implementation fees. Deferred amounts are generally recognized within one year. Those amounts that are expected to be recognized in greater than one year are recorded in other long-term liabilities in the accompanying condensed consolidated balance sheets.

Cost of Revenue

Cost of revenue primarily consists of personnel and related costs, including salaries, bonuses, payroll taxes and stock-based compensation, co-location facility costs for the Company’s data centers, depreciation expense for computer equipment directly associated with generating revenue, credit card transaction fees and infrastructure maintenance costs. In addition, the Company allocates a portion of overhead, such as rent and employee benefits costs, to cost of revenue based on headcount.

Fair Value of Financial Instruments

The Company uses a three-tier fair value hierarchy to classify and disclose all assets and liabilities measured at fair value on a recurring basis, as well as assets and liabilities measured at fair value on a non-recurring basis, in periods subsequent to their initial measurement. The hierarchy requires the Company to use observable inputs when available, and to minimize the use of unobservable inputs when determining fair value. The three tiers are defined as follows:

- Level 1. Observable inputs based on unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2. Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs for which there is little or no market data, which require the Company to develop its own assumptions.

The carrying amounts of certain of the Company’s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate their respective fair values due to their short-term nature.

The acquisition of E-Tale Holdings Limited ("E-Tale") on October 31, 2014 included a contingent consideration arrangement that allows for adjustment of payments based upon achievement of specified quarterly revenue targets through June 2017. Contingent consideration was measured at fair value at the acquisition date and is remeasured to fair value at each reporting date until the contingency is resolved. The fair value is reported within current and non-current liabilities on the condensed consolidated balance sheets. Increases or decreases in any valuation inputs in isolation may result in a significantly lower or higher fair value measurement in the future. Subsequent changes in the fair value of contingent consideration are recognized within general and administrative expenses in the

Company's condensed consolidated statements of operations.

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The fair value of contingent consideration related to the E-Tale acquisition is based on a probability-weighted model in which the Company developed various scenarios for E-Tale's projected quarterly revenue targets through June 2017. The Company discounted the expected future earn-out payment of each scenario to net present value using Level 3 inputs and assigned probabilities to achieving each scenario. Key assumptions used in the measurement of fair value of contingent consideration include a discount rate of 24% as of June 30, 2015 and December 31, 2014. The Company believes the discount rate used to discount the earn-out payments reflects market participant assumptions. Projected revenue is based on the Company's internal projections and analysis of the current customer base and expected customer growth, target market and sales potential.

The following table presents changes to the Company's liability for acquisition-related contingent consideration for the six months ended June 30, 2015 (in thousands):

	Six Months Ended June 30, 2015	
Balance as of January 1, 2015	$618	
Change in contingent consideration fair value	(53	)
Balance as of June 30, 2015	$565	

Concentration of Credit Risk

Financial instruments that subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. All of the Company's cash and cash equivalents are held at financial institutions that management believes to be of high credit quality. The Company's cash and cash equivalents accounts exceed federally insured limits. The Company has not experienced any losses on its cash and cash equivalents accounts to date. To manage accounts receivable risk, the Company maintains an allowance for doubtful accounts. The Company did not have any customers that individually comprised a significant concentration of its accounts receivable as of June 30, 2015 and December 31, 2014, or a significant concentration of its revenue for the three and six months ended June 30, 2015 and 2014.

Accounts Receivable and Allowance for Doubtful Accounts

The Company extends credit to customers without requiring collateral. Accounts receivable are stated at realizable value, net of an allowance for doubtful accounts. The Company utilizes the allowance method to provide for doubtful accounts based on management's evaluation of the collectability of amounts due. The Company's estimate is based on historical collection experience and a review of the current status of accounts receivable. Historically, actual write-offs for uncollectible accounts have not significantly differed from the Company's estimates.

Other Receivables

Under certain customer arrangements, the Company collects and remits monthly activity-based fees incurred on specific channels on the customers' behalf. The Company records the amounts due from customers as a result of these arrangements as other receivables.

Other receivables of $2.9 million and $1.3 million are included in prepaid expenses and other current assets on the condensed consolidated balance sheets as of June 30, 2015 and December 31, 2014, respectively.

Identifiable Intangible Assets

The Company acquired intangible assets in connection with its business acquisitions. These assets were recorded at their estimated fair values at the acquisition date and are being amortized over their respective estimated useful lives using the straight-line method. The estimated useful lives and amortization methodology used in computing amortization are as follows:

	Estimated Useful Lives	Amortization Methodology
Customer relationships	7 to 8 years	Straight-line
Proprietary software	8 years	Straight-line
Acquired technology	7 years	Straight-line
Trade names	3 years	Straight-line

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Amortization expense associated with the Company's intangible assets was $0.2 million and $0.1 million for the three months ended June 30, 2015 and 2014, respectively, and $0.5 million and $0.2 million for the six months ended June 30, 2015 and 2014, respectively.

Software Development Costs

The Company capitalizes certain internal-use software development costs, consisting primarily of direct labor associated with creating the internally developed software and third-party consulting fees associated with implementing software purchased for internal use. Software development projects generally include three stages: the preliminary project stage (in which all costs are expensed as incurred), the application development stage (in which certain costs are capitalized) and the post-implementation/operation stage (in which all costs are expensed as incurred). The costs incurred during the application development stage primarily include the costs of designing the application, coding and testing of the system. Capitalized costs are amortized using the straight-line method over the estimated useful life of the software once it is ready for its intended use.

Software development costs of $0.1 million and $0.4 million related to creating internally developed software and implementing software purchased for internal use were capitalized during the six months ended June 30, 2015 and the year ended December 31, 2014, respectively, and are included in property and equipment in the accompanying condensed consolidated balance sheets. Amortization expense related to capitalized internally developed software was $0.1 million and $48,000 for the three months ended June 30, 2015 and 2014, respectively, and $0.1 million for each of the six months ended June 30, 2015 and 2014 and is included in cost of revenue or general and administrative expense in the accompanying condensed consolidated statements of operations, depending upon the nature of the software development project. The net book value of capitalized internally developed software was $0.5 million and $0.6 million as of June 30, 2015 and December 31, 2014, respectively.

Software development costs of $0.3 million related to configuring and implementing hosted third-party software applications that the Company will use in its business operations were capitalized during the year ended December 31, 2014. There were no amounts capitalized during the six months ended June 30, 2015. These costs are included in property and equipment in the accompanying condensed consolidated balance sheets. Amortization expense related to hosted third-party software applications was $0.2 million for each of the three months ended June 30, 2015 and 2014, respectively, and $0.4 million and $0.3 million for the six months ended June 30, 2015 and 2014, respectively, and is included in general and administrative expense in the accompanying condensed consolidated statements of operations. The net book value of hosted third-party software applications was $1.0 million and $1.4 million as of June 30, 2015 and December 31, 2014, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method of accounting. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as for operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. The measurement of a deferred tax asset is reduced, if necessary, by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The Company applies the accounting guidance for uncertainties in income taxes, which prescribes a recognition threshold and measurement process for recording uncertain tax positions taken, or expected to be taken, in a tax return. Additionally, the guidance also prescribes the treatment for accounting in interim periods, derecognition, classification and disclosure requirements for uncertain tax positions. The Company accrues for the estimated amount of taxes for uncertain tax positions if it is more likely than not that the Company would be required to pay such additional taxes. An uncertain tax position will be recognized if it is not more likely than not to be sustained.

The Company’s income tax provision for the three and six months ended June 30, 2015 and 2014 reflects its estimates of the effective tax rates expected to be applicable for the full fiscal years, adjusted for any discrete events that are recorded in the period in which they occur. For the three and six months ended June 30, 2015 and 2014, the Company’s effective tax rate differs from the federal statutory rate primarily due to changes in the valuation allowance

and nondeductible expenses.
For the three and six months ended June 30, 2015 and 2014, the Company had net operating loss (“NOL”) carryforwards, the benefit of which is dependent on the Company’s ability to generate sufficient taxable income prior to the expiration of the NOL carryforwards. In addition, the maximum annual use of the NOL carryforwards is limited in certain situations, such as a change in stock ownership.

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Stock-Based Compensation

The Company accounts for stock-based compensation awards, which include stock options and restricted stock units ("RSUs"), based on the fair value of the award as of the grant date. The Company recognizes stock-based compensation expense using the accelerated attribution method, net of estimated forfeitures, in which compensation cost for each vesting tranche in an award is recognized ratably from the service inception date to the vesting date for that tranche.

The Company uses the Black-Scholes option pricing model for estimating the fair value of stock options. The use of the option valuation model requires the input of the Company's stock price, as well as highly subjective assumptions, including the expected life of the option and the expected stock price volatility based on peer companies. The fair value of the Company's common stock, for purposes of determining the grant date fair value of option and RSU awards, has been determined by using the closing market price per share of common stock as quoted on the New York Stock Exchange on the date of grant. The recognition of expense requires the estimation of the number of awards that will ultimately vest and the number of awards that will ultimately be forfeited.

3. Business Combination

On October 31, 2014, the Company’s wholly owned subsidiary, ChannelAdvisor UK Limited (“ChannelAdvisor UK”), entered into a Securities Purchase Agreement (the “Purchase Agreement”) pursuant to which ChannelAdvisor UK acquired all of the issued and outstanding shares of E-Tale, a UK-based company that offers a global Where to Buy solution (the "E-Tale Acquisition").

The initial aggregate purchase price associated with the E-Tale Acquisition totaled $9.0 million, which was comprised of $8.2 million of cash, $0.6 million for contingent consideration and $0.2 million of other items. During the six months ended June 30, 2015, the aggregate purchase price of the E-Tale Acquisition was adjusted by less than $0.1 million for post-closing working capital adjustments, in accordance with the Purchase Agreement. The purchase price allocation in conjunction with the E-Tale Acquisition is subject to change as additional information becomes available. Any adjustments will be made as soon as practicable, but not later than one year from the acquisition date. Comparative pro forma financial information for the E-Tale Acquisition has not been presented because the acquisition is not material to the Company’s consolidated results of operations.

4. Goodwill

The following table shows the changes in the carrying amount of goodwill for the six months ended June 30, 2015 (in thousands):

Balance as of January 1, 2015	$21,518
Adjustment to E-Tale Acquisition purchase price	(18)
Balance as of June 30, 2015	$21,500

5. Guarantee

In June 2014, the Company assigned its previous lease of office space in London, England to a third party pursuant to an assignment agreement and a transfer agreement. In accordance with the assignment agreement, the Company is not required to collect any payments from the third party and therefore will not recognize any revenue associated with this assignment. All payments associated with the assigned lease will be made directly by the third party to the lessor and appropriate regulatory authorities. However, the Company has guaranteed the lease payments through the remainder of the lease term, which is until February 2022. As of June 30, 2015, the remaining lease payments under this lease totaled £2.3 million ($3.6 million based on the exchange rate as of June 30, 2015). This amount represents the maximum potential liability for future payments under the guarantee and will decrease over time as payments are made by the third party. In the event of default, the indemnity clauses in the transfer agreement govern the Company's ability to pursue and recover damages incurred. As of June 30, 2015, the Company does not anticipate any default by the third party. Therefore, no liability associated with this transaction has been recorded on the Company's condensed consolidated balance sheet as of June 30, 2015.

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6. Equity Incentive Plan and Stock-Based Compensation

Stock-based compensation expense is included in the following line items in the accompanying condensed consolidated statements of operations for the three and six months ended June 30, 2015 and 2014 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Cost of revenue (excluding depreciation)	$276	$142	$539	$190
Sales and marketing	1,429	735	2,576	911
Research and development	514	232	898	298
General and administrative	1,067	1,028	2,163	1,368
	$3,286	$2,137	$6,176	$2,767

Stock Option Awards

The following table summarizes the stock option activity for the six months ended June 30, 2015:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding options as of January 1, 2015	1,425,357	$ 9.12		
Granted	402,500	10.49		
Exercised	(63,324)	4.59		
Forfeited	(74,693)	21.18		
Expired	(3,505)	28.14		
Outstanding options as of June 30, 2015	1,686,335	$ 9.04	7.59	$7,235
Exercisable as of June 30, 2015	896,124	$ 7.14	6.59	$5,499
Vested and expected to vest as of June 30, 2015	1,561,751	$ 8.88	7.51	$6,947

The total compensation cost related to nonvested stock options not yet recognized as of June 30, 2015 was $1.8 million and will be recognized over a weighted average period of approximately 2.0 years.

Restricted Stock Units

The following table summarizes the RSU activity for the six months ended June 30, 2015:

	Number of RSUs	Weighted Average Grant-Date Fair Value
Unvested RSUs as of January 1, 2015	944,734	$ 22.76
Granted	1,348,969	10.06
Vested	(151,865)	26.89
Forfeited	(111,659)	15.08
Unvested RSUs as of June 30, 2015	2,030,179	$ 14.44

The total unrecognized compensation cost related to the RSUs as of June 30, 2015 was $17.2 million and will be recognized over a weighted average period of approximately 2.1 years.

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7. Net Loss Per Share

Diluted loss per share is the same as basic loss per share for all periods presented because the effects of potentially dilutive items were anti-dilutive given the Company’s net loss. The following securities have been excluded from the calculation of weighted average common shares outstanding because the effect is anti-dilutive for the three and six months ended June 30, 2015 and 2014:

	Three and Six Months Ended June 30,	
	2015	2014
Warrants to purchase common stock	—	6,901
Stock options	1,686,335	1,687,969
RSUs	2,030,179	655,674

8. Segment and Geographic Information

Operating segments are defined as components of an enterprise for which discrete financial information is available that is evaluated regularly by the chief operating decision maker (“CODM”) for purposes of allocating resources and evaluating financial performance. The Company’s CODM reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. As such, the Company’s operations constitute a single operating segment and one reportable segment.

Substantially all assets were held in the United States during the six months ended June 30, 2015 and 2014. The following table summarizes revenue by geography for the three and six months ended June 30, 2015 and 2014 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Domestic	$18,603	$15,693	$36,223	$30,998
International	5,579	5,077	10,549	9,110
Total revenue	$24,182	$20,770	$46,772	$40,108

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MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements contained in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words or phrases “would be,” “will allow,” “intends to,” “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project,” or similar expressions, or the negative of such words or phrases, are intended to identify “forward-looking statements.” We have based these forward-looking statements on our current expectations and projections about future events. Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to these differences include those below and elsewhere in this Quarterly Report on Form 10-Q, particularly in Part II – Item 1A, “Risk Factors,” and our other filings with the Securities and Exchange Commission. Statements made herein are as of the date of the filing of this Form 10-Q with the Securities and Exchange Commission and should not be relied upon as of any subsequent date. Unless otherwise required by applicable law, we do not undertake, and we specifically disclaim, any obligation to update any forward-looking statements to reflect occurrences, developments, unanticipated events or circumstances after the date of such statement.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes that appear in Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and related notes for the year ended December 31, 2014, which are included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 26, 2015.

Overview

We are a leading provider of software-as-a-service, or SaaS, solutions that enable our retailer and manufacturer customers to integrate, manage and optimize their merchandise sales across hundreds of online channels. Through our platform, we enable our customers to connect with new and existing sources of demand for their products, including e-commerce marketplaces, such as eBay, Amazon, Newegg and Sears, search engines and comparison shopping websites, such as Google, Microsoft's Bing and Nextag, and emerging channels, such as Facebook and Pinterest. Our suite of solutions, accessed through a standard web browser, provides our customers with a single, integrated user interface to manage their product listings, inventory availability, pricing optimization, search terms, data analytics and other critical functions across these channels. We also offer a Where to Buy solution that allows branded manufacturers to send visitors to their website directly to authorized resellers and to gain insight into consumer behavior. Our proprietary cloud-based technology platform delivers significant breadth, scalability and flexibility to our customers.

We sell subscriptions to our SaaS solutions primarily through our direct sales force. Our customers include the online businesses of traditional retailers, online retailers and branded manufacturers, as well as advertising agencies that use our solutions on behalf of their retailer clients. As of June 30, 2015, we had over 2,900 customers worldwide, including 33% of the top 500 U.S. internet retailers, as identified by Internet Retailer magazine based on their 2014 online sales.

The majority of our revenue is derived from subscription fees paid to us by our customers for access to and usage of our SaaS solutions for a specified contract term, which is usually one year. A portion of the subscription fee is typically fixed and is based on a specified minimum amount of gross merchandise value, or GMV, that a customer expects to process through our platform. The remaining portion of the subscription fee is variable and is based on a specified percentage of GMV processed through our platform in excess of the customer’s specified minimum GMV amount.

We do not take title to any of the merchandise processed through our platform and we generally do not collect payments on behalf of our customers. We do not hold any inventory of merchandise and we are not involved in the physical logistics of shipping merchandise to buyers, which is handled by our customers.

We face a variety of challenges and risks, which we will need to address and manage as we pursue our growth strategy. In particular, we will need to continue to innovate in the face of a rapidly changing e-commerce landscape if we are to remain competitive, and we will need to effectively manage our growth, especially related to our international expansion. In addition, as consumer preferences potentially shift from smaller retailers, we need to continue to add large retailers and branded manufacturers as profitable customers. These customers generally pay a lower percentage of GMV as fees to us based on the relatively higher volume of their GMV processed through our platform. We continue to focus our efforts on increasing value for our customers to support higher rates.

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Although e-commerce continues to expand as retailers and manufacturers continue to increase their online sales, it is also becoming more complex and fragmented due to the hundreds of channels available to retailers and manufacturers and the rapid pace of change and innovation across those channels. In order to gain consumers' attention in a more crowded and competitive online marketplace, many retailers and an increasing number of manufacturers sell their merchandise through multiple online channels, each with its own rules, requirements and specifications. In particular, third-party marketplaces are an increasingly important driver of growth for a number of large online retailers, and as a result we need to continue to support multiple channels in a variety of geographies in order to support our targeted revenue growth. As of June 30, 2015, we supported 49 marketplaces, up from 41 at December 31, 2014.

We believe the growth in e-commerce globally presents an opportunity for retailers and manufacturers to engage in international sales. However, country-specific marketplaces are often the market share leaders in their regions, as is the case for Alibaba in Asia and MercadoLibre in much of Latin America. In order to help our customers capitalize on this potential market opportunity, and to address our customers' needs with respect to cross-border trade, over the past few years, we have expanded our presence in the Asia-Pacific and Latin America regions through the opening of two offices in China and an office in Brazil. Doing business overseas involves substantial challenges, including management attention and resources needed to adapt to multiple languages, cultures, laws and commercial infrastructure, as further described in this report under the caption "Risks Related to our International Operations."

Our senior management continuously focuses on these and other trends and challenges, and we believe that our culture of innovation and our history of growth and expansion will contribute to the success of our business. We cannot, however, assure you that we will be successful in addressing and managing the many challenges and risks that we face.

Key Financial and Operating Performance Metrics

We regularly monitor a number of financial and operating metrics in order to measure our performance and project our future performance. These metrics aid us in developing and refining our growth strategies and making strategic decisions.

Number of Customers

The number of customers subscribing to our solutions is a primary determinant of our revenue. The number of customers was 2,937 and 2,673 as of June 30, 2015 and 2014, respectively. For these purposes, we include all customers who subscribe to at least one of our solutions, but we exclude customers who subscribe only to one of our legacy product offerings from prior to 2008 that are focused on solutions for lower-volume eBay sellers and which are no longer part of our strategic focus.

Average Revenue per Customer

The average revenue generated by our customers is the other primary determinant of our revenue. We calculate this metric by dividing our revenue for a particular period by the average monthly number of customers during the period, which is calculated by taking the sum of the number of customers at the end of each month in the period and dividing by the number of months in the period. We typically calculate average revenue per customer in absolute dollars on a rolling twelve-month basis, but we may also calculate percentage changes in average revenue per customer on a quarterly basis in order to help us evaluate our period-over-period performance. Our average revenue per customer increased 2.8% to $32,022 for the twelve months ended June 30, 2015 as compared to $31,160 for the twelve months ended June 30, 2014.

Subscription Dollar Retention Rate

We believe that our ability to retain our customers and expand the revenue they generate for us over time is an important component of our growth strategy and reflects the long-term value of our customer relationships. We measure our performance on this basis using a metric we refer to as our subscription dollar retention rate. We calculate this metric for a particular period by establishing the cohort of customers that had active contracts as of the end of the prior period. We then calculate our subscription dollar retention rate by taking the amount of fixed subscription revenue we recognized for the cohort in the period for which we are reporting the rate and dividing it by the fixed subscription revenue we recognized for the same cohort in the prior period. For this purpose, we do not include any variable subscription fees paid by our customers or any implementation fees.

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Although some customers in any given period elect not to renew their contracts with us, our customers that do renew their subscriptions often increase their fixed subscription pricing levels to align with their increasing GMV volumes processed through our platform and may subscribe to additional modules as well. If our subscription dollar retention rate for a period is over 100%, this means that the increased subscription revenue we recognized from customers that renewed their contracts during the period, or whose contracts did not come up for renewal during the period, more than offset the subscription revenue we lost from customers that did not renew their contracts.

For each of the twelve months ended June 30, 2015 and 2014, our subscription dollar retention rate exceeded 100%.

Adjusted EBITDA

Adjusted EBITDA represents our earnings before interest expense, income tax expense and depreciation and amortization, adjusted to eliminate stock-based compensation expense, which is a non-cash item, and one-time severance and related costs. We believe that the exclusion of the expenses 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. However, adjusted EBITDA is not a measure calculated in accordance with U.S. GAAP and should not be considered as an alternative to any measure of financial performance calculated and presented in accordance with U.S. GAAP.

Adjusted EBITDA eliminates the impact of stock-based compensation expense and one-time severance and related costs, which we do not consider indicative of our operating performance. Our use of adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- although depreciation and amortization 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 changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not reflect the potentially dilutive impact of equity-based compensation;
- adjusted EBITDA does not reflect interest or tax payments that may represent a reduction in cash available to us; and
- other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net loss	$(6,524)	$(9,604)	$(15,480)	$(18,974)
Adjustments:				
Interest expense, net	38	47	82	102
Income tax (benefit) expense	11	49	(127)	81
Depreciation and amortization expense	2,089	1,318	4,022	2,652
Total adjustments	2,138	1,414	3,977	2,835
EBITDA	(4,386)	(8,190)	(11,503)	(16,139)
Stock-based compensation expense	3,286	2,137	6,176	2,767
One-time severance and related costs	656	—	656	—
Adjusted EBITDA	$(444)	$(6,053)	$(4,671)	$(13,372)

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Components of Operating Results

Revenue

We derive the majority of our revenue from subscription fees paid to us by our customers for access to and usage of our SaaS solutions for a specified contract term, which is usually one year. A portion of the subscription fee is typically fixed and based on a specified minimum amount of GMV that a customer expects to process through our platform. The remaining portion of the subscription fee is variable and is based on a specified percentage of GMV processed through our platform in excess of the customer's specified minimum GMV. In most cases, the specified percentage of excess GMV on which the variable portion of the subscription is based is fixed and does not vary depending on the amount of the excess. We also receive implementation fees, which may include fees for providing launch assistance and training.

The following table shows the percentage of our total revenue attributable to fixed subscription fees plus implementation fees, as compared to the percentage attributable to variable subscription fees, for the three and six months ended June 30, 2015 and 2014:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015		2014		2015		2014	
	(as a percentage of total revenue)							
Fixed subscription fees plus implementation fees	78.2	%	75.6	%	78.1	%	74.3	%
Variable subscription fees	21.8		24.4		21.9		25.7	
Total revenue	100.0	%	100.0	%	100.0	%	100.0	%

Because our customer contracts generally contain both fixed and variable pricing components, changes in GMV between periods do not translate directly or linearly into changes in our revenue. We use customized pricing structures for each of our customers depending upon the individual situation of the customer. For example, some customers may commit to a higher specified minimum GMV amount per month in exchange for a lower fixed percentage fee on that committed GMV. In addition, the percentage fee assessed on the variable GMV in excess of the committed minimum for each customer is typically higher than the fee on the fixed, committed portion. As a result, our overall revenue could increase or decrease even without any change in overall GMV between periods, depending on which customers generated the GMV. In addition, changes in GMV from month to month for any individual customer that are below the specified minimum amount would have no effect on our revenue from that customer, and each customer may alternate between being over the committed amount or under it from month to month. For these reasons, while GMV is an important qualitative and long-term directional indicator, we do not regard it as a useful quantitative measurement of our historic revenues or as a predictor of future revenues.

We recognize fixed subscription fees and implementation fees ratably over the contract period once the contract has been signed by both parties, the customer has access to our platform and transactions can be processed, the fees are fixed or determinable and collection is reasonably assured.

We generally invoice our customers for the fixed portion of the subscription fee in advance, in monthly, quarterly, semi-annual or annual installments. We invoice our customers for the implementation fee at the inception of the arrangement. Fixed subscription and implementation fees that have been invoiced are initially recorded as deferred revenue and are generally recognized ratably over the contract term.

We invoice and recognize revenue from the variable portion of subscription fees in the period in which the related GMV is processed, assuming that the four conditions specified above have been met.

Cost of Revenue (excluding depreciation)

Cost of revenue (excluding depreciation) primarily consists of salaries and personnel-related costs for employees providing services to our customers and supporting our platform infrastructure, including benefits, bonuses and stock-based compensation. Additional expenses include co-location facility costs for our data centers, infrastructure maintenance costs, fees we pay to credit card vendors in connection with our customers' payments to us and other direct costs. We plan to continue to expand our capacity to support our growth, which will result in higher cost of revenue in absolute dollars.

Depreciation - Cost of Revenue
Depreciation expense related to cost of revenue consists primarily of depreciation for computer equipment directly associated with generating revenue.

Operating Expenses

Sales and marketing expense. Sales and marketing expense consists primarily of salaries and personnel-related costs for our sales and marketing and customer support employees, including benefits, bonuses, stock-based compensation and commissions. We record expense for commissions at the time of contract signing. Additional expenses include marketing, advertising and promotional event programs, corporate communications and travel.

Research and development expense. Research and development expense consists primarily of salaries and personnel-related costs for our research and development employees, including benefits, bonuses and stock-based compensation. Additional expenses include costs related to the development, quality assurance and testing of new technology and enhancement of our existing platform technology, consulting and travel.

General and administrative expense. General and administrative expense consists primarily of salaries and personnel-related costs for administrative, finance and accounting, information systems, legal and human resource employees, including benefits, bonuses and stock-based compensation. Additional expenses include consulting and professional fees, insurance, bad debt expense, investor relations, directors' and officers' liability insurance, other corporate expenses and travel, as well as costs associated with compliance with the Sarbanes-Oxley Act and other regulations governing public companies.

Depreciation and amortization expense. Depreciation and amortization expense consists primarily of depreciation from property and equipment, equipment leased under capital leases and amortization of software development costs and intangible assets.

Other Income (Expense)

Other income (expense) consists primarily of interest income and interest expense. Interest income represents interest received on our cash and cash equivalents. Interest expense consists primarily of interest on our capital leases. Other income (expense) also includes the net effect of foreign currency revaluation gains and losses.

Seasonality

Our revenue fluctuates as a result of seasonal variations in our business, principally due to the peak consumer demand and related increased volume of our customers’ GMV during the year-end holiday season. As a result, we have historically had higher revenue in our fourth quarter than other quarters in a given year due to increased GMV processed through our platform, resulting in higher variable subscription fees. Along with the seasonally higher revenue we have experienced in the fourth quarter, we have also experienced higher gross margins in the fourth quarter. Our cost to run our platform infrastructure is generally fixed. Therefore, when applied against our generally fixed costs, the higher revenue in the fourth quarter has resulted in higher overall gross margins for us.

Inflation

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. We continue to monitor the impact of inflation in order to minimize its effects through pricing strategies, productivity improvements and cost reductions. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Critical Accounting Policies and Estimates

Our management’s discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reported period. In accordance with U.S. GAAP, we base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions, and to the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected. During the six months ended June 30, 2015, there were no material changes to our critical accounting policies and use of estimates, which are disclosed in our audited consolidated financial statements for the year ended December 31, 2014 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 26, 2015.

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Recent Accounting Pronouncements

Refer to Note 2 to our condensed consolidated financial statements for a full description of recent accounting pronouncements.

Results of Operations

Comparison of the Three Months Ended June 30, 2015 and 2014

The following table presents our results of operations for the three months ended June 30, 2015 and 2014:

	Three Months Ended June 30,					
	2015		2014		Period-to-Period Change	
	Amount	Percentage of Revenue	Amount	Percentage of Revenue	Amount	Percentage
	(dollars in thousands)					
Revenue	$24,182	100.0 %	$20,770	100.0 %	$3,412	