STAMPS.COM INC
Form 10-Q
November 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended 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: 000-26427
Stamps.com Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	77-0454966
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1990 E. Grand Avenue
El Segundo, California 90245
(Address of Principal Executive Offices and Zip Code)

(310) 482-5800
(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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Emerging growth company

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

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

• As of October 31, 2018, there were 18,102,028 shares of the Registrant's Common Stock issued and outstanding.

STAMPS.COM INC. AND SUBSIDIARIES
FORM 10-Q QUARTERLY REPORT FOR THE QUARTER ENDED SEPTEMBER 30, 2018

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 78,264	$ 153,903
Accounts receivable, net	95,850	80,797
Current income taxes	23,717	22,344
Other current assets	34,499	14,449
Total current assets	232,330	271,493
Property and equipment, net	36,801	37,507
Goodwill	378,805	239,705
Intangible assets, net	171,815	80,990
Deferred income taxes, net	32,083	43,148
Other assets	7,560	6,261
Total assets	$ 859,394	$ 679,104
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 115,312	$ 103,076
Deferred revenue	4,694	3,871
Current portion of debt, net of debt issuance costs	9,938	8,392
Total current liabilities	129,944	115,339
Long-term debt, net of debt issuance costs	53,189	60,642
Deferred income taxes, net	15,331	—
Other liabilities	8,288	5,310
Total liabilities	206,752	181,291
Commitments and contingencies (Note 3)		
Stockholders' equity:		
Common stock, $.001 par value per share		
Authorized shares: 47,500 in 2018 and 2017		
Issued shares: 33,017 in 2018 and 32,177 in 2017		
Outstanding shares: 18,168 in 2018 and 17,573 in 2017	56	55
Additional paid-in capital	1,037,955	962,227
Treasury stock, at cost, 14,849 shares in 2018 and 14,604 in 2017	(439,969)	(387,545)
Retained earnings (accumulated deficit)	49,051	(76,930)
Accumulated other comprehensive income	5,549	6
Total stockholders' equity	652,642	497,813
Total liabilities and stockholders' equity	$ 859,394	$ 679,104

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

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STAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Service	$127,810	$97,529	$373,932	$292,634
Product	4,705	4,824	15,276	15,301
Insurance	4,023	4,099	12,684	12,932
Customized postage	6,957	8,588	14,755	15,306
Other	12	22	52	69
Total revenues	143,507	115,062	416,699	336,242
Cost of revenues (exclusive of amortization of intangible assets, which is included in general and administrative expense):				
Service	25,102	11,882	68,361	37,284
Product	1,383	1,535	4,614	4,930
Insurance	933	966	2,945	3,547
Customized postage	5,706	7,151	12,173	12,600
Total cost of revenues	33,124	21,534	88,093	58,361
Gross profit	110,383	93,528	328,606	277,881
Operating expenses:				
Sales and marketing	26,743	20,588	78,280	66,018
Research and development	14,432	12,037	38,845	34,187
General and administrative	24,916	25,243	71,119	65,676
Total operating expenses	66,091	57,868	188,244	165,881
Income from operations	44,292	35,660	140,362	112,000
Foreign currency exchange gain (loss), net	(957)	—	(957)	—
Interest expense	(668)	(967)	(1,908)	(2,779)
Interest income and other income, net	83	120	175	309
Income before income taxes	42,750	34,813	137,672	109,530
Income tax expense (benefit)	9,337	(11,412)	11,691	(873)
Net income	$33,413	$46,225	$125,981	$110,403
Net income per share:				
Basic	$1.84	$2.71	$7.02	$6.51
Diluted	$1.75	$2.49	$6.69	$6.04
Weighted average shares outstanding:				
Basic	18,161	17,073	17,942	16,969
Diluted	19,046	18,548	18,822	18,282

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

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STAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$33,413	$46,225	$125,981	$110,403
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	5,544	—	5,544	—
Unrealized gain (loss) on investments	(1)	—	(1)	(4)
Comprehensive income	$38,956	$46,225	$131,524	$110,399

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

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STAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2018			2017		
Operating activities:						
Net income	$	125,981		$	110,403	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	16,861			16,055		
Stock-based compensation expense	26,350			33,669		
Deferred income tax expense	10,929			8,650		
Accretion of debt issuance costs	279			279		
Changes in operating assets and liabilities, net of assets and liabilities acquired:						
Accounts receivable	(5,054		)	10,201		
Other current assets	(16,716		)	(31,535		)
Current income taxes	(1,373		)	—		
Other assets	(1,299		)	(2,073		)
Deferred revenue	560			(261		)
Other liabilities	2,183			—		
Accounts payable and accrued expenses	1,363			3,647		
Net cash provided by operating activities	160,064			149,035		
Investing activities:						
Acquisition of MetaPack, net of cash acquired	(208,500		)	—		
Sale of short-term investments	—			1,502		
Sale of long-term investments	—			10		
Purchase of long-term investments	—			(4		)
Acquisition of property and	(1,587		)	(5,972		)

equipment				
Net cash used in investing activities	(210,087	)	(4,464	)
Financing activities:				
Proceeds from short term financing obligation, net of repayments	678		(389	)
Principal payments on term loan	(6,187	)	(4,641	)
Payment on revolving credit facility	(12,716	)	(10,000	)
Proceeds from exercise of stock options	45,625		48,054	
Issuance of common stock under Employee Stock Purchase Plan	3,755		2,937	
Repurchase of common stock	(52,424	)	(103,127	)
Payments related to tax withholding for share-based compensation	(4,144	)	(799	)
Net cash used in financing activities	(25,413	)	(67,965	)
Effect of exchange rate changes	(203	)	—	
Net (decrease) increase in cash and cash equivalents	(75,639	)	76,606	
Cash and cash equivalents at beginning of period	153,903		106,932	
Cash and cash equivalents at end of period	$ 78,264		$ 183,538	
Supplemental information:				
Capital expenditures accrued but not paid at period end	$ 13		$ 123	
Tenant improvement allowance	$ 600		$ 848	

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

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STAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Summary of Significant Accounting Policies

Basis of Presentation

We prepared the consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures are adequate to make the information presented not misleading. We recommend that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in our latest annual report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on February 28, 2018.

In our opinion, these unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) considered necessary to present fairly our financial position as of September 30, 2018, our results of operations for the three and nine months ended September 30, 2018, and our cash flows for the nine months ended September 30, 2018. The results of operations for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2018.

Basis of Consolidation

The consolidated financial statements include all the assets, liabilities, revenues, expenses and cash flows of Stamps.com Inc. and the entities in which we have 100% voting and/or economic control, which includes Auctane LLC (ShipStation), Interapptive, Inc. (ShipWorks), MetaPack Limited (MetaPack), PSI Systems, Inc. (Endicia), ShippingEasy Group, Inc. (ShippingEasy) and PhotoStamps Inc. In July 2016, we completed our acquisition of 100% of the outstanding shares of ShippingEasy. In August 2018, we completed our acquisition of 100% of the outstanding shares of MetaPack. Please see Note 2 - “Acquisitions” in our Notes to Consolidated Financial Statements for further description. References in this Report to "we" "us" "our" or "Company" are references to Stamps.com Inc. and its subsidiaries.
Intercompany accounts and transactions between consolidated entities have been eliminated in consolidation.
Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates, judgments and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ from those estimates, and such differences may be material to the consolidated financial statements. Significant estimates and judgments inherent in the preparation of the consolidated financial statements include the fair value of assets and liabilities for allocation of the purchase price of companies acquired, estimates of loss contingencies, and estimates related to the realizability of deferred income taxes.
Business Combinations

The acquisition method of accounting is used for business combinations. The results of operations of acquired businesses are included in our consolidated financial statements prospectively from the date of acquisition. The fair value of purchase consideration is allocated to the assets acquired and liabilities assumed from the acquired entity and is generally based on their fair value at the acquisition date. The excess of the fair value of purchase consideration over the fair value of the assets acquired and liabilities assumed is recorded as goodwill. Historically, the primary items that have generated goodwill include anticipated synergies between the acquired business and the Company and the acquired assembled workforce, neither of which qualifies for recognition as an intangible asset. Acquisition-related expenses are recognized in our consolidated financial statements as incurred.

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Contingencies and Litigation

In the ordinary course of business, we are subject to various routine litigation matters as a claimant and a defendant. We record any amounts recovered in these matters when received. We establish loss provisions for claims against us when the loss is both probable and can be reasonably estimated. If either or both of the criteria are not met, we assess whether there is at least a reasonable possibility that a loss, or additional losses, may have been incurred. If there is a reasonable possibility that a loss or additional loss may have been incurred for such proceedings, we disclose the estimate of the amount of loss or possible range of loss, or disclose that an estimate of loss cannot be made, as applicable.

Deferred Revenue

Our deferred revenue relates mainly to service revenue, which generally arises due to the timing of payment versus the provision of services for certain customers billed in advance. Approximately $2.6 million of revenue recognized in the nine months ended September 30, 2018 was included in the deferred revenue balance at December 31, 2017.

Fair Value of Financial Instruments

Carrying amounts of certain of our financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate fair value due to their short maturities. The Company's outstanding debt held by third-party financial institutions is carried at cost, adjusted for debt issuance costs. The Company's debt is not publicly traded and the carrying amount typically approximates fair value for debt that accrues interest at a variable rate for companies with similar financial characteristics as the Company, which are considered Level 2 fair value inputs as defined in Note 8 in our Consolidated Financial Statements.

Foreign Currency Translation

The functional currency of the Company's major foreign subsidiaries is generally the local currency. Adjustments resulting from translating foreign functional currency financial statements into United States dollars are recorded in accumulated other comprehensive income as a component of stockholders' equity. Foreign currency transaction gains and losses are included in foreign currency exchange gain (loss), net. All assets and liabilities denominated in a foreign currency are translated into United States dollars at the exchange rate on the balance sheet date. Revenues and expenses are translated at the average exchange rate during the period.

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Goodwill and Indefinite-Lived Intangible Assets

Goodwill represents the excess of the fair value of consideration given over the fair value of the tangible assets, identifiable intangible assets and liabilities assumed in a business combination. We are required to test goodwill for impairment annually and whenever events or circumstances indicate the fair value of a reporting unit may be below its carrying value. A reporting unit is the operating segment or a business that is one level below that operating segment. Reporting units are aggregated as a single reporting unit if they have similar economic characteristics.

Goodwill is reviewed for impairment annually on October 1 utilizing either a qualitative assessment or a two-step process. We have an option to make a qualitative assessment of a reporting unit's goodwill for impairment. If we choose to perform a qualitative assessment and determine the fair value more likely than not exceeds the carrying value, no further evaluation is necessary. When we perform the two-step process, the first step requires us to compare the fair value of our reporting unit, which we primarily determine using an income approach based on the present value of discounted cash flows, to the respective carrying value, which includes goodwill. If the fair value of our reporting unit exceeds its carrying value, the goodwill is not considered impaired. If the carrying value is higher than the fair value, there is an indication that impairment may exist and the second step is required. In step two, the implied fair value of goodwill is calculated as the excess of the fair value of our reporting unit over the fair values assigned to its assets and liabilities. If the implied fair value of goodwill is less than the carrying value of our reporting unit's goodwill, the difference is recognized as an impairment loss. As of September 30, 2018, we are not aware of any indicators of impairment that would require an impairment analysis other than our annual goodwill impairment analysis.

Indefinite-lived intangible assets are reviewed for impairment annually on October 1. In assessing other intangible assets not subject to amortization for impairment, the Company also has the option to perform a qualitative assessment to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of such an intangible asset is less than its carrying amount. If the Company determines that it is not more likely than not that the fair value of such an intangible asset is less than its carrying amount, then the Company is not required to perform any additional tests for assessing those intangible assets for impairment. However, if the Company concludes otherwise or elects not to perform the qualitative assessment, then it is required to perform a quantitative impairment test that involves a comparison of the estimated fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. As of September 30, 2018, we are not aware of any indicators of impairment that would require an impairment analysis other than our annual indefinite-lived intangible assets impairment analysis.

Long-Lived Assets and Finite-Lived Intangible Assets

Long-lived assets including intangible assets with finite useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

We account for property and equipment at cost less accumulated depreciation and amortization. We compute depreciation using the straight-line method over the estimated useful life of the asset, generally three to five years for furniture, fixtures, and equipment and ten to forty years for building and building improvements. Leasehold improvements are capitalized and amortized over the shorter of the useful life of the asset or the remaining term of the lease. We have a policy of capitalizing expenditures that materially increase assets' useful lives and charging ordinary maintenance and repairs to operations as incurred. When property or equipment is disposed of, the cost and related accumulated depreciation and amortization are removed, and any gain or loss is included in income from operations.

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Income Taxes

We account for income taxes in accordance with Financial Accounting Standards Board (FASB) ASC Topic No. 740, Income Taxes (Income Taxes), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax basis of recorded assets and liabilities. Income Taxes also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the net deferred tax assets will not be realized. We record a valuation allowance to reduce our gross deferred tax assets to the amount that is more likely than not (a likelihood of more than 50 percent) to be realized. In order for us to realize our deferred tax assets, we must be able to generate sufficient taxable income. We evaluate the appropriateness of our deferred tax assets and related valuation allowance in accordance with Income Taxes based on all available positive and negative evidence.

Revenue Recognition

We recognize revenues when we transfer control of promised goods or services to our customers in an amount that reflects the consideration to which we expect to be entitled to in exchange for those goods or services. We account 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. Our payment terms vary by the products and services offered. The term between billings and when payment is due is not significant.

Revenues are presented on a disaggregated basis on the consolidated statements of income.

Service revenues are recognized at a point in time, as transactions are processed, or over a period of time, typically one month or less. We earn service revenue from our mailing and shipping operations in several different ways: (1) customers may pay us a monthly fee based on a subscription plan which may be waived or refunded for certain customers; (2) we may be compensated directly by the United States Postal Service (USPS) for certain qualifying customers under our USPS partnership; (3) we may earn transaction related revenue based on customers purchasing postage or printing shipping labels; (4) we may earn compensation by offering customers a discounted postage rate that is provided to the customers by our integration partners; and (5) we may earn other types of revenue shares or other compensation from specific customers or integration partners.

Customers may purchase postage and other delivery services from the USPS and other carriers through our mailing and shipping solutions. When funds are transferred directly from customers to the carrier, these funds are not recognized as revenue. We also provide mailing and shipping services for which the cost of postage or delivery is included in the cost of the service and, therefore, is recognized as service revenue.

Product revenue consists of products sold through the mailing and shipping supplies stores which are available to our customers from within some of our mailing and shipping solutions. Products sold include shipping labels, mailing labels, dedicated postage printers, scales, and other mailing and shipping-focused office supplies. We recognize product revenue on product purchases upon delivery of the order to the customer.

We provide our customers with the opportunity to purchase parcel insurance directly through our solutions. Insurance revenue represents the gross amount charged to the customer for purchasing insurance and the related cost represents the amount paid to our insurance providers. We recognize insurance revenue on insurance purchases upon the ship date of the insured package.

Customized postage revenue, which includes the face value of postage, from the sale of customized postage sheets and rolls is recognized upon transfer of control of the product to the customer, which occurs upon our delivery to the carrier.

On a limited basis, we allow third parties to offer products and promotions to our customer base. These arrangements generally provide payment in the form of a flat fee or revenue sharing arrangements where we receive payment upon customers accessing third party products and services. Total revenue from such advertising arrangements was not significant during the nine months ended September 30, 2018 or 2017, respectively.

Segment Information

We have organized our operations into two segments: Stamps.com and MetaPack. Please see Note 10 - “Segment and Geographical Information” in our Notes to Consolidated Financial Statements for further description.

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Short-Term Financing Obligations

We utilize short-term financing, which is separate from our debt, to fund certain Company operations. Short-term financing obligations are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. As of September 30, 2018, we had $17.9 million in short-term financing obligations and $87.6 million of unused credit. As of December 31, 2017, we had $17.2 million in short-term financing obligations and $103.4 million of unused credit.

Stock-Based Compensation

We account for share-based employee compensation plans under the fair value recognition and measurement provisions in accordance with applicable accounting standards, which require all share-based payments to employees, including grants of stock options and restricted stock units (RSUs), to be measured based on the grant date fair value of the awards, with the resulting expense generally recognized on a straight-line basis over the period during which the employee is required to perform service in exchange for the award.

We account for forfeitures as they occur. Prior to the adoption of ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, in 2017, share-based compensation expense was recorded net of estimated forfeitures, which were based on historical forfeitures and adjusted to reflect changes in facts and circumstances, if any.

We use the Black-Scholes-Merton option valuation model to estimate the fair value of share-based payment awards on the date of grant, which requires us to use a number of estimates and subjective assumptions, including stock price volatility, expected term, risk-free interest rates, and projected employee stock option exercise behaviors. In the case of options we grant, our assumption of expected volatility is based on the historical volatility of our stock price over the term equal to the expected life of the options. We base the risk-free interest rate on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life of the options assumed at the date of grant. The estimated expected life represents the weighted average period the stock options are expected to remain outstanding, determined based on an analysis of historical exercise behavior.

Trademarks, Trade Names, and Other Intangible Assets (excluding Goodwill)

Acquired trademarks, trade names, and other intangibles (excluding goodwill) include both amortizable and non-amortizable assets and are included in intangible assets, net in the accompanying consolidated balance sheets. Intangible assets are carried at cost less accumulated amortization. Cost associated with internally developed intangible assets is typically expensed as incurred as research and development costs. Amortization of amortizable intangible assets is calculated on a straight-line basis, which is consistent with the expected future cash flows.

Treasury Stock

During the nine months ended September 30, 2018 and September 30, 2017, we repurchased approximately 223,000 shares and 818,000 shares for $48.3 million and $103.1 million, respectively. Also, in the first quarter of 2018 and the first quarter of 2017, we withheld 21,076 and 6,670 of shares, respectively, to satisfy income tax obligations related to performance-based inducement equity awards issued to the General Manager and the then Chief Technology Officer of ShippingEasy as described in Note 2 - “Acquisitions.”

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(UNAUDITED)

Accounting Guidance Adopted in 2018

Definition of a Business

In January 2017, the FASB issued ASU 2017-01, guidance that changes the definition of a business for accounting purposes. Under the new guidance, an entity first determines whether substantially all of the fair value of a set of assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If this threshold is met, the set of assets is not deemed to be a business. If this threshold is not met, the entity then evaluates whether the set of assets meets the requirement to be deemed a business, which at minimum, requires there to be an input and a substantive process that together significantly contribute to the ability to create outputs. The guidance became effective on a prospective basis for the Company on January 1, 2018. The Company's adoption of the guidance on January 1, 2018 did not have a material impact on the Company's consolidated financial statements.

Modification of Share-Based Payments

In May 2017, the FASB issued ASU 2017-09, guidance that clarifies when changes to the terms and conditions of share-based awards must be accounted for as modifications. The guidance does not change the accounting treatment for modifications. The guidance became effective for the Company on January 1, 2018 and was adopted on a prospective basis. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, an updated standard on revenue recognition. This ASU superseded the revenue recognition requirements in Accounting Standards Codification Topic 605, Revenue Recognition, and most industry-specific guidance. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using U.S. GAAP and International Financial Reporting Standards. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies may be required to use more judgment and make more estimates than under current authoritative guidance.

On January 1, 2018, the Company adopted the guidance under the modified retrospective method. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

Accounting Guidance Not Yet Adopted

Disclosure Update and Simplification

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, Disclosure Update and Simplification, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. This final rule is effective for quarterly reporting for quarters which begin after November 5, 2018. The Company is in the process of evaluating the impact of the final rule on its consolidated financial statements.

Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, a standard which simplifies the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance will become effective on a prospective basis for the Company on January 1, 2020 and is not expected to have a material impact on the Company's consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, a new accounting standard for leases. The new standard generally requires the recognition of financing and operating lease liabilities and corresponding right-of-use assets on the balance sheet. For financing leases, a lessee recognizes amortization of the right-of-use asset as an operating expense over the lease term separately from interest on the lease liability. For operating leases, a lessee recognizes its total lease expense as an operating expense over the lease term. The amendments are effective for the Company in the first quarter of 2019 using a modified retrospective approach with early adoption permitted. Although the Company is in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements, the Company currently believes the most significant change will be related to the recognition of right-of-use assets and lease liabilities on the Company's balance sheet for real estate operating leases.

2. Acquisitions

We have accounted for all of our acquisitions under the acquisition method of accounting in accordance with the provisions of FASB ASC Topic No. 805, Business Combinations.

MetaPack Acquisition

On August 15, 2018, we, through our wholly owned subsidiary Pacific Shelf 1855 Limited (Pacific Shelf), completed the acquisition of MetaPack Limited, a private limited company incorporated in England and Wales, pursuant to a share purchase agreement dated July 24, 2018, as amended (the “Agreement”), by and among the certain key sellers named in the Agreement (the “Key Sellers”), MetaPack, Pacific Shelf, and Stamps.com Inc. as Pacific Shelf’s guarantor.

MetaPack provides multi-carrier enterprise-level solutions to many of the world's preeminent e-commerce retailers and brands.

Pursuant to the Agreement and a related agreement to purchase Minority Shares (as defined below), Pacific Shelf acquired 100% of MetaPack's issued and to be issued share capital by purchasing (i) all of the Key Sellers' shares of MetaPack, representing approximately 80% of the total outstanding shares and (ii) all other issued and to be issued shares of MetaPack (Minority Shares), for a final adjusted purchase price, for all such shares, of approximately £171 million, or $217.7 million using the August 15, 2018 GBP to USD exchange rate. Total cash paid for the acquisition was funded from cash and investment balances.

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Stamps.com granted inducement stock options for an aggregate of 320,250 shares of Stamps.com common stock to 72 new employees after completion of its acquisition of MetaPack. The stock options were granted as inducements material to the new employees entering into employment with Stamps.com, pursuant to the Stamps.com 2018 MetaPack Equity Inducement Plan, which was approved by Stamps.com's Compensation Committee. The awards were granted without stockholder approval in accordance with Nasdaq Listing Rule 5635(c)(4). Each option vests 25% on the one year anniversary of the grant date with the remaining 75% vesting in approximately equal monthly increments over the succeeding thirty-six months, provided that the option holder is still employed by Stamps.com or one of its subsidiaries on the vesting dates. The stock options have a ten year term and an exercise price equal to closing price of Stamps.com common stock on the grant date of August 15, 2018.

Under the acquisition method of accounting under ASC 805, the total purchase price of the acquired company is allocated to the assets acquired and the liabilities assumed based on their fair values. We have made significant estimates and assumptions in determining the preliminary allocation of the purchase price. The Company has made a preliminary allocation of the purchase price of MetaPack to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair value. The preliminary allocation of the purchase price is based upon management's estimates and is subject to revision, as a more detailed analysis of intangible assets and tax and other liabilities is completed and additional information on the fair value of assets and liabilities becomes available. A change in the fair value of the net assets may change the amount of the purchase price allocable to goodwill, and could impact the amounts of amortization expense.

The purchase price of MetaPack has been allocated on a preliminary basis as follows to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair value based on the August 15, 2018 GBP to USD exchange rate (in thousands, except years):

	Fair Value	Fair Value	Useful Life (In Years)	Weighted Average Estimated Useful Life (In Years)
Cash and cash equivalents	$9,186			
Trade accounts receivable	9,767			
Other current assets	3,259			
Property and equipment	1,179			
Goodwill	135,747			
Identifiable intangible assets:				
Trade names		$10,936	12	
Developed technology		40,691	16	
Customer relationships		49,211	16	
Total identifiable intangible assets	100,838			16
Accounts payable and accrued expenses	(13,450)			
Deferred revenue	(254)			
Revolving credit facility	(12,716)			
Deferred income tax liability	(15,094)			
Other liabilities	(776)			
Total purchase consideration	$217,686			

The fair value of the assets acquired and liabilities assumed were preliminarily determined using income, cost and market participant approaches. The fair value measurements were primarily based on significant inputs that are not observable in the market and thus represent a Level 3 measurement as defined in ASC 820. The identified intangible assets consist of trade names, developed technology, and customer relationships. The estimated fair values of the trade names and developed technology were determined using the “relief from royalty” method. The estimated fair value of customer relationships was determined using the “excess earnings” method. The rate utilized to discount net cash flows to their present values was approximately 15% and was determined after consideration of the overall enterprise rate of return and the relative risk and importance of the assets to the generation of future cash flows. Intangible assets are being amortized on a straight-line basis over their estimated useful lives. Based on the September 30, 2018 exchange rate, we expect the amortization of acquired intangibles will be approximately $1.7 million per quarter for the remaining estimated useful lives.

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Deferred taxes were adjusted to record the deferred tax impact of acquisition accounting adjustments primarily related to intangible assets. The incremental deferred tax liabilities were calculated based on the tax effect of the step-up in book basis of the net assets of MetaPack, excluding the amount attributable to goodwill, using the estimated statutory tax rates.

Goodwill represents the excess of the consideration given over the sum of the fair values assigned to identifiable assets acquired less liabilities assumed in a business combination. The goodwill balance is primarily attributable to the expanded market opportunities for the Company internationally and MetaPack in the United States and the Company's ability to generate future technology. None of the goodwill recognized is expected to be deductible for income tax purposes. The goodwill recorded as part of this acquisition is included in the MetaPack segment (see Note 6 - “Goodwill and Intangible Assets” in our Notes to Consolidated Financial Statements).

Immediately following the acquisition, we repaid in full MetaPack's existing revolving credit facility balance of approximately $12.7 million.

We incurred approximately $2.5 million in transaction costs included in general and administrative expense and $1.0 million of nonrecurring foreign currency exchange loss directly related to the acquisition during the nine months ended September 30, 2018.

MetaPack revenues and net loss included in the Consolidated Statements of Operations for the three months ended September 30, 2018 are $5.2 million and $1.3 million, respectively.

Pro Forma Financial Information (unaudited)

The pro forma financial information presented is for illustrative purposes only and is not necessarily indicative of the results of operations that would have been realized if the acquisition had been completed on the date assumed, nor is it indicative of future operating results. The pro forma financial information does not include any adjustments for anticipated operating efficiencies or cost savings. The pro forma results include material adjustments related to (a) purchase accounting, primarily amortization of intangible assets, (b) share-based compensation expense for inducement awards issued to continuing employees of MetaPack, and (c) the elimination of nonrecurring expenses that were directly related to the transaction, including transaction costs, foreign currency exchange loss, and one-time bonuses and related tax payments.

The following table presents the pro forma financial information (in thousands, except per share amounts) and assumes the acquisition of MetaPack occurred on January 1, 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue	$150,697	$125,715	$449,644	$367,295
Net income	33,432	43,918	122,341	101,009
Basic earnings per share	$1.84	$2.57	$6.82	$5.95
Diluted earnings per share	$1.76	$2.37	$6.50	$5.53

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ShippingEasy Acquisition

On July 1, 2016, we completed our acquisition of ShippingEasy Group, Inc. (ShippingEasy). The net purchase price including adjustments for net working capital totaled approximately $55.4 million and was funded from current cash and investment balances.

In connection with the acquisition, we agreed to issue performance-based inducement equity awards to the General Manager and the then Chief Technology Officer of ShippingEasy. These inducement awards cover an aggregate of up to 87,134 common shares if earnings targets for ShippingEasy are achieved over a two and one-half year period which began July 1, 2016. The awards are subject to proration if at least 75% of the applicable target is achieved and are subject to forfeiture or acceleration based on changes in employment circumstances over the performance period.

In fiscal 2016, we determined the achievement of 100% of the earnings target for the six months ended December 31, 2016 was met, therefore, we recognized approximately $1.9 million of stock-based compensation expense, representing 21,783 shares, for these inducement equity awards during the six months ended December 31, 2016. The equity award for the first phase was issued in the first quarter of 2017 with 15,113 shares distributed and 6,670 shares withheld to satisfy income tax obligations. In fiscal 2017, we determined the achievement of 100% of the earnings target for the twelve months ended December 31, 2017 was met, therefore, we recognized approximately $4.9 million of stock-based compensation expense, representing 56,638 shares, for these inducement equity awards during the year ended December 31, 2017. The equity award for the second phase was issued in the first quarter of 2018 with 35,562 shares distributed and 21,076 shares withheld to satisfy income tax obligations. As of the third quarter of 2018, we estimated the achievement of the earnings target for the twelve months ended December 31, 2018 is probable. Stock-based compensation expense related to these inducement equity awards was not material during the three and nine months ended September 30, 2018.

We also issued inducement stock option grants for an aggregate of approximately 62,000 shares of Stamps.com common stock to 48 new employees in connection with our acquisition of ShippingEasy.

3. Commitments and Contingencies

Legal Proceedings

We are subject to various routine legal proceedings and claims incidental to our business, and we do not believe that these proceedings and claims would reasonably be expected to have a material adverse effect on our financial position, results of operations, or cash flows.

On February 8, 2018, a putative class action complaint was filed against us in a case entitled Juan Lopez and Nicholas Dixon v. Stamps.com, Inc., Case No. 2:18-cv-01101, in the United States District Court for the Central District of California, Western Division, alleging wage and hour claims on behalf of our current and former “non-exempt” hourly call center employees. The complaint sought class certification, unspecified damages, unpaid wages, penalties, restitution, interest, and attorneys’ fees and costs. On July 24, 2018, we entered into a preliminary settlement that would resolve this matter for a non-material payment to be distributed to the participating class members. The court granted preliminary approval of the settlement and has scheduled a final approval hearing to be held on February 11, 2019, or on another date convenient to the court.

The Company had not accrued any material amounts related to any of the Company’s legal proceedings as of September 30, 2018 or December 31, 2017.

Although management at present believes that the ultimate outcome of the various routine proceedings, individually and in the aggregate, will not materially harm our financial position, results of operations, cash flows, or overall trends, legal proceedings are subject to inherent uncertainties, and unfavorable rulings or other events could occur. An unfavorable outcome for an amount in excess of management's present expectations may result in a material adverse impact on our business, results of operations, financial position, and overall trends.

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Commitments

The Company leases facilities pursuant to noncancelable operating lease agreements expiring through 2028. Rent expense is recognized on a straight-line basis over the lease term. Lease incentives are amortized over the lease term on a straight-line basis. Leasehold improvements are capitalized and amortized over the shorter of the useful life of the asset or the remaining term of the lease. Rent expense for the three and nine months ended September 30, 2018 was approximately $1.2 million and $3.0 million, respectively. Rent expense for the three and nine months ended September 30, 2017 was approximately $1.0 million and $2.8 million, respectively.

The following table is a schedule of our significant contractual obligations and commercial commitments (other than debt commitments), which consist of minimum operating lease payments as of September 30, 2018 (in thousands):

Twelve Month Period Ending September 30,	Operating Lease Obligations
2019	$ 5,217
2020	5,243
2021	4,906
2022	3,802
2023	3,461
Thereafter	4,634
Total	$ 27,263

4. Net Income per Share

The following table reconciles share amounts utilized to calculate basic and diluted net income per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$33,413	$46,225	$125,981	$110,403
Basic - weighted average common shares	18,161	17,073	17,942	16,969
Diluted effect of common stock equivalents	885	1,475	880	1,313
Diluted - weighted average common shares	19,046	18,548	18,822	18,282
Earnings per share:				
Basic	1.84	2.71	7.02	6.51
Diluted	1.75	2.49	6.69	6.04

The calculation of dilutive shares excludes the effect of the following options that are considered anti-dilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Anti-dilutive stock options	143	30	102	24

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5. Stock-Based Compensation

We account for share-based employee compensation plans under the fair value recognition and measurement provisions in accordance with applicable accounting standards, which require all share-based payments to employees, including grants of stock options and RSUs, to be measured based on the grant date fair value of the awards, with the resulting expense generally recognized on a straight-line basis over the period during which the employee is required to perform service in exchange for the award. Starting in the third quarter of fiscal 2016, our stock-based compensation expense included performance-based inducement equity awards relating to the ShippingEasy acquisition as described in Note 2 - "Acquisitions." Starting in the third quarter of fiscal 2018, our stock-based compensation expense included performance-based inducement equity awards relating to the MetaPack acquisition as described in Note 2 - "Acquisitions."

The following table sets forth the stock-based compensation expense that we recognized for the periods indicated (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock-based compensation expense relating to:				
Stock options	$8,500	$11,065	$25,198	$32,923
Employee stock purchases	411	269	1,151	746
Total stock-based compensation expense	$8,911	$11,334	$26,349	$33,669
Stock-based compensation expense relating to:				
Cost of revenues	$785	$444	$1,998	$1,437
Sales and marketing	1,816	1,915	4,818	6,197
Research and development	2,001	2,337	5,593	7,054
General and administrative	4,309	6,638	13,940	18,981
Total stock-based compensation expense	$8,911	$11,334	$26,349	$33,669

The following are the weighted average assumptions used in the Black-Scholes-Merton option valuation model for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Expected dividend yield	— %	— %	— %	— %
Risk-free interest rate	2.7 %	1.5 %	2.5 %	1.5 %
Expected volatility	49.8%	47.9%	50.3%	46.9%
Expected life (in years)	3.3	3.3	3.3	3.4

6. Goodwill and Intangible Assets

Goodwill represents the excess of the fair value of consideration given over the fair value of the tangible assets, identifiable intangible assets and liabilities assumed in business combinations.

The following table summarizes goodwill as of December 31, 2017 and September 30, 2018 (in thousands):

	Stamps.com Segment	MetaPack Segment	Total
Goodwill balance at December 31, 2017	$ 239,705	$—	$239,705
Acquisition of MetaPack (see Note 2 - "Acquisitions")	—	135,747	135,747
Foreign currency translation	—	3,353	3,353
Goodwill balance at September 30, 2018	$ 239,705	$139,100	$378,805

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We have amortizable and non-amortizable intangible assets consisting of trademarks, trade names, developed technology, non-compete agreements, customer relationships, and other. The gross carrying amount of amortizable and non-amortizable intangible assets was $229.0 million at September 30, 2018 and $125.4 million at December 31, 2017. Non-amortizable assets of $11.4 million as of both September 30, 2018 and December 31, 2017 consist primarily of the trade name relating to the Endicia acquisition.

The following table summarizes our amortizable intangible assets as of September 30, 2018 (in thousands, except years):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Remaining weighted average amortization period (years)
Patents and Others	$8,889	$ 8,854	$35	0.7
Customer Relationships	111,373	30,043	81,330	8.9
Technology	81,853	15,520	66,333	10.6
Non-Compete	2,211	1,611	600	2.7
Trademarks and Trade Names	13,249	1,120	12,129	11.1
Total amortizable intangible assets at September 30, 2018	$217,575	$ 57,148	$160,427	9.7

The following table summarizes our amortizable intangible assets as of December 31, 2017 (in thousands, except years):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Remaining weighted average amortization period (years)
Patents and Others	$8,889	$ 8,820	$69	1.5
Customer Relationships	60,816	22,170	38,646	3.9
Technology	40,048	11,297	28,751	5.9
Non-Compete	2,211	1,280	931	2.0
Trademark	2,004	800	1,204	4.6
Total amortizable intangible assets at December 31, 2017	$113,968	$ 44,367	$69,601	4.6

We recorded amortization of intangible assets totaling approximately $4.8 million and $12.8 million for the three and nine months ended September 30, 2018, respectively. We recorded amortization of intangible assets totaling approximately $4.0 million and$12.0 million for the three and nine months ended September 30, 2017, respectively. Amortization of intangible assets is included in general and administrative expense in the accompanying consolidated statements of income.

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

Twelve Month Period Ending September 30,	Estimated Amortization Expense
2019	$ 22,314

2020	22,236
2021	21,113
2022	12,190
2023	9,754
Thereafter	72,820
Total	$ 160,427

7. Income Taxes

Our income tax expense was $9.3 million and $11.7 million for the three and nine months ended September 30, 2018, respectively. The income tax expense for the three and nine months ended September 30, 2018 was primarily due to (a) our pre-tax income multiplied by an estimated annual effective tax rate and (b) discrete tax benefits related to the exercises of stock awards of approximately $1.6 million and $22.5 million, respectively. Our income tax benefit was $11.4 million and $0.9 million for the three and nine months ended September 30, 2017, respectively. The income tax benefit for the three and nine months ended September 30, 2017 was primarily due to (a) our pre-tax income multiplied by an estimated annual effective tax rate and (b) discrete tax benefits related to the exercises of stock awards of approximately $23.5 million and $41.8 million, respectively.

Our effective income tax rate differs from the statutory income tax rate primarily as a result of permanent tax adjustments for tax benefits from exercises of stock awards and research and development tax credits, as well as nondeductible items and state taxes. As of September 30, 2018 and December 31, 2017, we have recorded a valuation allowance of $654,000 and $410,000 against certain state research and development credits for which we believe it is more likely than not that these deferred tax assets will not be realized. We also have recorded a valuation allowance against the activity of certain foreign jurisdictions.

We recorded provisional amounts as of December 31, 2017 related to certain income tax effects of the Tax Cuts and Jobs Act enacted December 22, 2017 under guidance set forth in Staff Accounting Bulletin No. 118 (SAB 118). These amounts have not been adjusted as of September 30, 2018, and we will continue to monitor any changes to the provisional amounts during the measurement period or until the accounting is complete. Any subsequent adjustment to these amounts will be recorded to current tax expense in the fourth quarter of 2018 when the analysis is complete.

8. Fair Value Measurements

Financial assets measured at fair value on a recurring basis are classified in one of the three categories described below:

Level 1 - Valuations based on unadjusted quoted prices for identical assets in an active market

Level 2 - Valuations based on quoted prices in markets where trading occurs infrequently or whose values are based on quoted prices of instruments with similar attributes in active markets

Level 3 - Valuations based on inputs that are unobservable and involve management judgment and our own assumptions about market participants and pricing

The following tables summarize our financial assets measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 (in thousands):

		Fair Value Measurement at Reporting Date Using		
Description	September 30, 2018	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

		(Level 1)		
Cash and cash equivalents	$ 78,264	$ 78,264	—	—
Total	$ 78,264	$ 78,264	—	—

Description	December 31, 2017	Fair Value Measurement at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 153,903	$ 153,903	—	—
Total	$ 153,903	$ 153,903	$	——

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9. Cash and Cash Equivalents

Our cash equivalents consisted of money market funds at September 30, 2018 and December 31, 2017. We consider all highly liquid investments with an original or remaining maturity of three months or less at the date of purchase to be cash equivalents. At September 30, 2018 and December 31, 2017, we had no material investments.

The following tables summarize our cash and cash equivalents as of September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	$71,662	—	—	$ 71,662
Money market	6,602	—	—	6,602
Cash and cash equivalents	$78,264	—	—	$ 78,264

	December 31, 2017			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	$147,386	—	—	$147,386
Money market	6,517	—	—	6,517
Cash and cash equivalents	$153,903	—	—	$153,903

10. Segment Information and Geographic Data

Segment 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 Chairman and Chief Executive Officer has been identified as the CODM as defined by guidance regarding segment disclosures.

The Company’s reportable segments have been determined based on the distinct nature of their operations and customer bases, and the financial information that is evaluated regularly by the CODM. Following the MetaPack acquisition (see Note 2), the Company has added a new segment for the MetaPack business. Previously, the Company had a single reportable segment.

The Stamps.com segment derives revenue from external customers from offering postage online and shipping software solutions offered to consumers, small businesses, e-commerce shippers, enterprise mailers, and high volume shippers. The Stamps.com reportable segment includes the results of brand names Stamps.com, Endicia, ShipStation, ShipWorks and ShippingEasy. Stamps.com's customers are primarily located in the US.

The MetaPack segment consists of the operations of MetaPack which derives revenues from external customers from offering multi-carrier enterprise-level shipping software solutions to large e-commerce retailers and brands. MetaPack's customers are primarily located outside the US.

Revenues, cost of revenues, and operating expenses are generally directly attributed to our segments. Inter-segment revenues are not presented separately, as these amounts are immaterial. Our CODM does not evaluate operating segments using asset information.

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Information about segments during the periods presented were as follows (in thousands, unaudited):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Segment revenues				
Stamps.com	$138,270	$115,062	$411,462	$336,242
MetaPack	5,237	—	5,237	—
Total revenues	$143,507	$115,062	$416,699	$336,242
Segment income (loss) from operations				
Stamps.com	$45,593	$35,660	$141,663	$112,000
MetaPack	(1,301)	—	(1,301)	—
Total income from operations	$44,292	$35,660	$140,362	$112,000
Company's total segment income from operations	$44,292	$35,660	$140,362	$112,000
Foreign currency exchange loss, net	(957)	—	(957)	—
Interest expense	(668)	(967)	(1,908)	(2,779)
Interest income and other income, net	83	120	175	309
Income before income taxes	$42,750	$34,813	$137,672	$109,530

Geographic Data

No sales to an individual customer or country other than the US accounted for more than 10% of revenue for the three or nine months ended September 30, 2018 or 2017. The following table presents our revenues by geography, based on the billing addresses of our customers (in thousands, unaudited):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues				
United States	$137,853	$115,062	$409,853	$336,242
International	5,654	—	6,846	—
Total revenues	$143,507	$115,062	$416,699	$336,242

11. Subsequent Events

We are not aware of any material subsequent events or transactions that have occurred that would require recognition in the financial statements or disclosure in the notes to the financial statements.

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

This Quarterly Report on Form 10-Q (this "Report") contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). You can find many (but not all) of these statements by looking for words such as "approximates," "believes," "expects," "anticipates," "estimates," "projects," "seeks," "intends," "plans," "could," "would," "may" or other similar expressions in this Report. Our forward-looking statements relate to future events or our future performance and include, but are not limited to, statements concerning our business strategy, future commercial revenues, market growth, capital requirements, new product introductions, expansion plans and the adequacy of our funding. Other statements contained in this Report that are not historical facts are also forward-looking statements.

We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. We caution investors that any forward-looking statements presented in this Report, or that we may make orally or in writing from time to time, are based on beliefs and assumptions made by us and information available to us at the time made. Such statements are based on assumptions, and the actual outcome will be affected by known and unknown risks, trends, uncertainties, and factors that are beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance, and some will inevitably prove to be incorrect. As a result, our actual future results can be expected to differ from our expectations, and those differences may be material. Accordingly, investors should use caution in relying on forward-looking statements to anticipate future results or trends.

Please refer to the risk factors under "Item 1A. Risk Factors" of our Form 10-K for the year ended December 31, 2017 and those described under Item 1A of Part II of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, as well as those described elsewhere in this Report and in our other public filings. The risks included are not exhaustive, and additional factors could adversely affect our business and financial performance. We operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time, and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. This Report and all subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances after the date of this Report.

Our trade names and registered trademarks include Stamps.com, Endicia, MetaPack, ShipStation, Auctane, ShipWorks, ShippingEasy, NetStamps, PhotoStamps, and the Stamps.com logo. This Report also references trade names and trademarks of other entities. References in this Report to "we" "us" "our" or "Company" are references to Stamps.com Inc. and its subsidiaries.

Overview

Stamps.com® is a leading provider of Internet-based mailing and shipping solutions in the United States and Europe. Under the Stamps.com and Endicia® brands, customers use our USPS only solutions to mail and ship a variety of mail pieces and packages through the USPS. Customers using our solutions receive discounted postage rates compared to USPS.com and USPS retail locations on certain mail pieces such as First Class letters and domestic and international Priority Mail® and Priority Mail Express® packages. Stamps.com was the first ever USPS-approved PC Postage vendor to offer a software only mailing and shipping solution in 1999. Endicia became a USPS-approved PC

Postage vendor in 2000. Under the MetaPack, ShipStation®, ShipWorks®, and ShippingEasy® brands, customers use our multi-carrier solutions to ship packages through multiple carriers such as the USPS, UPS, FedEx, and others. Our customers include individuals, small businesses, home offices, medium-size businesses, large enterprises, e-commerce merchants, and warehouse shippers.

Mailing and Shipping Business References

When we refer to our "mailing and shipping business," we are referring to our mailing and shipping products and services including our USPS and multi-carrier mailing and shipping solutions, mailing and shipping integrations, mailing and shipping supplies stores, and branded insurance offerings. We do not include our customized postage business when we refer to our mailing and shipping business. When we refer to our "mailing and shipping revenue," we are referring to our service, product, and insurance revenue generated by our mailing and shipping customers. We do not include our customized postage revenue generated by our customized postage business in our "mailing and shipping revenue."

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Services and Products

Mailing and Shipping Business

We offer the following mailing and shipping products and services to our customers under the Stamps.com, Endicia, MetaPack, ShipStation, ShipWorks, and ShippingEasy brands:

USPS Mailing and Shipping Solutions

Under the Stamps.com and Endicia brands, customers use our USPS-approved mailing and shipping solutions to mail and ship a variety of mail pieces and packages through the USPS. Customers can purchase and print postage 24 hours a day, seven days a week, through our software or web interfaces. Typically, customers fund an account balance prior to using our service.

Our USPS mailing and shipping solutions enable users to print "electronic postage" directly onto envelopes, plain paper, or labels using only a standard personal computer, printer, and Internet connection. Our solutions support a variety of USPS mail classes including First Class Mail®, Priority Mail, Priority Mail Express, Media Mail®, Parcel Select®, and others. Customers can also add USPS Special Services to their mail pieces, such as USPS Tracking®, Signature Confirmation™, Registered Mail®, Certified Mail®, Insured Mail, Return Receipt, Collect on Delivery, and Restricted Delivery. Our customers can print postage (1) on NetStamps® or DYMO Stamps® labels, which can be used just like regular stamps, (2) on envelopes and postcards or on labels in a single step process that saves time and provides a professional look, (3) on plain 8.5" x 11" paper or on special labels for packages, and (4) on integrated customs forms for international mail and packages.

Our mailing and shipping solutions incorporate address verification technology that verifies each destination address for mail or packages sent using our solutions against a database of all known addresses in the United States. Our mailing and shipping solutions are also integrated with common small business and productivity software applications such as word processing, contact and address management, and accounting and financial applications. Our shipping solutions feature integrations with hundreds of partners and carriers including popular shipping management products, shopping carts, online marketplaces, and other e-commerce solutions.

We target different customer categories with service plans that provide various features and capabilities. We target smaller offices, home offices, and smaller online sellers that need a more basic set of mailing and shipping features. We target larger enterprises that need a richer set of mailing capabilities such as multiple-user functionality, automated Certified Mail forms, additional reference codes and higher allowable postage balances. We target shippers such as e-commerce merchants, online retailers, fulfillment houses, warehouses, and large retailers that need shipping specific features such as direct integration into the customer's order databases, faster label printing speed, and the ability to customize and save shipping profiles. We target large corporations with multiple geographic locations that need enhanced reporting and the ability for a central location, such as a corporate headquarters, to have greater visibility and control over postage expenditures across their distributed network of locations. We target large volume mailers that need features designed for presort mail, Certified Mail, and bulk address updating.

Customers typically pay us a monthly subscription fee which varies depending on their service plan. In certain circumstances, customers may be on a plan where they do not owe us any monthly service fees. Under certain plans or arrangements, customers or integration partners pay a fee per transaction for shipping labels printed. We have arrangements with the USPS where we are compensated directly if a customer or integration partner prints certain classes and amounts of domestic or international USPS shipping labels. We may waive or refund our service fees for these or other customers. In addition, we also have service plans with lower monthly subscription fees which offer more limited functionality and are targeted at retaining customers who print a lower volume of postage. We offer service plans where customers are not charged a monthly fee but instead purchase labels for use as needed. We also offer high volume mailing products for an annual fee. We also earn compensation by offering customers a discounted postage rate that is provided to the customers by our integration partners, and we may earn other types of revenue share or other compensation from specific customers or partners.

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Multi-Carrier Shipping Solutions

We offer multi-carrier shipping solutions through our MetaPack, ShipStation, ShipWorks, and ShippingEasy brands. MetaPack, ShipStation, ShipWorks, and ShippingEasy offer leading multi-carrier solutions for shippers including e-commerce merchants, online retailers, warehouses, fulfillment houses, large retailers, and other types of shippers that use multiple carriers such as the USPS, FedEx, UPS, DHL, Canada Post, Royal Mail, and many others.

MetaPack, which we acquired on August 15, 2018, provides multi-carrier enterprise-level solutions to many of the world’s preeminent e-commerce retailers and brands. MetaPack provides its customers access to a carrier library with support for over 450 parcel carriers. MetaPack's platform also provides sophisticated solutions including carrier management, a carrier optimization engine, a track and trace system, a parcel returns system, a delivery analysis and carrier SLA monitoring system, a sophisticated cross-border solution, and a system that provides dynamic delivery options right in the shopping cart. From a single integration, Metapack’s customers are able to offer delivery choice and convenience in all major e-commerce markets around the world. Metapack’s software also improves its customers’ shopping cart order conversion rates and order delivery satisfaction ratings.

ShippingEasy, which we acquired on July 1, 2016, offers web-based multi-carrier shipping solutions that allow online retailers and e-commerce merchants to organize, process, fulfill, and ship their orders quickly and easily. ShippingEasy's solutions feature over 50 integrations with partners and carriers, including marketplaces, shopping carts, and e-commerce platforms, allowing its customers to import and export fulfillment and tracking data in real time across all of their selling channels. ShippingEasy's solutions download orders from all selling channels and automatically map custom shipping preferences, rates, and delivery options across all of its supported carriers. ShippingEasy's easy-to-use solutions also include complimentary access to ShippingEasy customer service shipping specialists helping merchants to streamline workflow and save on shipping costs.

ShipWorks, which we acquired on August 29, 2014, offers software-based multi-carrier shipping solutions that target e-commerce merchants, online retailers, fulfillment houses, and warehouses. ShipWorks offers simple, powerful, and easy to use solutions for shippers. ShipWorks' solutions feature over 100 integrations with partners and carriers, including marketplaces, shopping carts and e-commerce platforms. ShipWorks offers multi-carrier shipping options and features including importing orders from any marketplace or shopping cart, easily comparing shipping rates and services, sending email notifications to buyers, updating online order status, generating reports, and many more.

ShipStation, which we acquired on June 10, 2014, offers web-based multi-carrier shipping solutions under the brand names ShipStation and Auctane® that target e-commerce merchants, online retailers, fulfillment houses, and warehouses. ShipStation's solutions feature over 200 integrations with partners and carriers, including marketplaces, shopping carts, and e-commerce platforms. ShipStation offers multi-carrier shipping options and automation features like custom hierarchical rules and product profiles that allow customers to easily and automatically optimize their shipping. Using ShipStation, an online retailer or e-commerce merchant can ship their orders from wherever they sell and however they ship.

Mailing and Shipping Integrations

As part of our mailing and shipping services, we offer back-end integration solutions where we provide the electronic postage for transactions to partners who manage the front-end users. Our solutions integrate directly into the most popular e-commerce platforms, allowing web store managers to completely automate their order fulfillment process by processing, managing, and shipping orders from virtually any e-commerce source through a single interface without manual data entry. Managers can retrieve order data and print complete shipping labels for all types of packages.

We have integration partnerships with the USPS where we provide electronic postage for mailing and shipping transactions generated by certain USPS-branded programs. For example, we provide the electronic postage for Click-N-Ship®, a web-based service available at USPS.com that allows USPS customers to purchase and print shipping labels for certain domestic and international mail classes or packages at no additional mark-up over the cost of postage.

In addition, MetaPack, ShipStation, ShipWorks, and ShippingEasy have hundreds of integrations with partners and carriers, including marketplaces, shopping carts, and e-commerce platforms as part of their multi-carrier shipping solutions. Integrations with partners include Amazon, eBay, PayPal, Shopify, BigCommerce, Magento, Volusion, ChannelAdvisor, Yahoo! Stores, and many others. Carrier integrations include USPS, FedEx, UPS, DHL, Canada Post, Royal Mail, and many others.

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Mailing & Shipping Supplies Stores

Stamps.com and Endicia's mailing & shipping supplies stores (our "Supplies Stores") are available to our customers from within our mailing and shipping solutions and sell NetStamps labels, DYMO Stamp labels, shipping labels, other mailing labels, dedicated postage printers, scales, and other mailing and shipping-focused office supplies. Our Supplies Stores feature store catalogs, messaging regarding free or discounted shipping promotions, cross-selling product recommendations during the checkout process, product search capabilities, and same-day shipping of orders with expedited shipping options. Our multi-carrier solutions do not have mailing and shipping supplies stores as part of their solutions.

Branded Insurance

We offer branded insurance for USPS packages to our customers so that they may insure their mail or packages in a fully integrated, online process that eliminates any trips to the post office or the need to complete any special forms. Our branded insurance is offered by certain brands including Stamps.com, Endicia, ShipStation, ShipWorks, and ShippingEasy as part of their USPS and multi-carrier solutions. Our branded insurance is provided by our insurance providers.

International

We offer International postage solutions for both our US domestic customers shipping to destinations outside the US and, primarily through our subsidiaries, postage solutions for customers outside the US directly from international posts. Some of our international carriers include the French Post, Royal Mail, Canada Post, and Australia Post.

Customized Postage

We offer customized postage under the PhotoStamps® brand name. Customized postage is a patented form of postage that allows consumers to turn digital photos, designs or images into valid USPS-approved postage. With these products, individuals or businesses can create customized USPS-approved postage using pictures of their children, pets, vacations, celebrations, business logos, and more. Customized postage can be used as regular postage to send letters, postcards or packages. PhotoStamps are available from our www.photostamps.com website.

Acquisitions

MetaPack

On August 15, 2018, we, through our wholly owned subsidiary Pacific Shelf 1855 Limited, completed the acquisition of MetaPack Limited for a final adjusted purchase price of approximately £171 million, or $217.7 million using the August 15, 2018 GBP to USD exchange rate. The purchase price was funded from cash and investment balances.

Stamps.com granted inducement stock options for an aggregate of 320,250 shares of Stamps.com common stock to 72 new employees after completion of its acquisition of MetaPack.

Please see Note 2 - "Acquisitions" in our Notes to Consolidated Financial Statements for further description.

ShippingEasy

On July 1, 2016, we completed our acquisition of ShippingEasy. The net purchase price including adjustments for net working capital totaled approximately $55.4 million and was funded from current cash and investment balances.

In connection with the acquisition, we issued performance based inducement equity awards to the General Manager and the then Chief Technology Officer of ShippingEasy. These inducement awards cover an aggregate of up to 87,134 common shares if earnings targets for ShippingEasy are achieved over a two and one-half year period which began July 1, 2016. The awards are subject to proration if at least 75% of the applicable target is achieved and are subject to forfeiture or acceleration based on changes in employment circumstances over the performance period.

We also issued inducement stock option grants for an aggregate of 62,000 shares of Stamps.com common stock to 48 new employees in connection with our acquisition of ShippingEasy.

Please see Note 2 - "Acquisitions" in our Notes to Consolidated Financial Statements for further description.

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Results of Operations

The results of our operations during the three and nine months ended September 30, 2018 include MetaPack's operations beginning on the August 15, 2018 acquisition date. The results of our operations during the three and nine months ended September 30, 2017 do not include the operations of MetaPack. Please see Note 2 – "Acquisitions" in our Notes to Consolidated Financial Statements for further description. Accordingly, care should be used in comparing periods that include the operations of MetaPack with those that do not include such operations.

Three and Nine Months Ended September 30, 2018 and 2017

Total revenue increased 25% to $143.5 million in the three months ended September 30, 2018 from $115.1 million in the three months ended September 30, 2017. Total revenue increased 24% to $416.7 million in the nine months ended September 30, 2018 from $336.2 million in the nine months ended September 30, 2017. Mailing and shipping revenue, which includes service revenue, product revenue, and insurance revenue, was $136.5 million in the three months ended September 30, 2018, an increase of 28% from $106.5 million in the three months ended September 30, 2017. Mailing and shipping revenue was $401.9 million in the nine months ended September 30, 2018, an increase of 25% from $320.9 million in the nine months ended September 30, 2017. Customized postage revenue decreased 19% to $7.0 million in the three months ended September 30, 2018 from $8.6 million in the three months ended September 30, 2017. Customized postage revenue decreased 4% to $14.8 million in the nine months ended September 30, 2018 from $15.3 million in the nine months ended September 30, 2017.

The following table sets forth the breakdown of revenue for the three and nine months ended September 30, 2018 and 2017 and the resulting percentage change (revenue in thousands):

	Three months ended September 30,			Nine months ended September 30,		
	2018	2017	% Change	2018	2017	% Change
Revenues						
Service	$127,810	$97,529	31.0 %	$373,932	$292,634	27.8 %
Product	4,705	4,824	(2.5)%	15,276	15,301	(0.2)%
Insurance	4,023	4,099	(1.9)%	12,684	12,932	(1.9)%
Mailing and shipping revenue	136,538	106,452	28.3 %	401,892	320,867	25.3 %
Customized postage	6,957	8,588	(19.0)%	14,755	15,306	(3.6)%
Other	12	22	(45.5)%	52	69	(24.6)%
Total revenues	$143,507	$115,062	24.7 %	$416,699	$336,242	23.9 %

We define "paid customers" for the quarter as ones from whom we successfully collected service fees or otherwise earned revenue at least once during that quarter, and we define average monthly revenue per paid customer (ARPU) as one-third of quarterly mailing and shipping revenue divided by paid customers. We define lost paid customers (Lost Paid Customers) as customers from whom we successfully collected service fees or otherwise earned revenue at least once during the previous quarter but not during the current quarter, less recaptured paid customers. We define monthly paid customer cancellation rate (Monthly Churn) as a fraction, the numerator of which is the quotient of Lost Paid Customers in a quarter divided by the sum of paid customers in the prior quarter and new paid customers in the current quarter, and the denominator of which is three months.

The following table sets forth the number of paid customers in the period for our mailing and shipping business (in thousands):

Year	First Quarter	Second Quarter	Third Quarter
2018	740	737	732
2017	722	738	736

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The following table sets forth the change in paid customers and average monthly revenue per paid customer for our mailing and shipping business (in thousands except average monthly revenue per paid customer and percentage):

	Three months ended September 30,		
	2018	2017	% Change
Paid customers for the quarter	732	736	(0.5)%
Average monthly revenue per paid customer	$62.14	$48.23	28.8 %
Mailing and shipping revenue	$136,538	$106,452	28.3 %

The number of paid customers was approximately flat in the three months ended September 30, 2018 and 2017 primarily as a result of our strategic shift to focusing on the acquisition of high-volume shipper customers, which are numerically fewer, but generally have a much higher lifetime value.

The increase in our average monthly revenue per paid customer was primarily the result of the growth in our shipping business where we have the ability to better monetize postage volume as compared to monthly flat rate subscription fees, growth in international service offerings to our domestic customers, and revenues from our acquisition of MetaPack.

Revenue by Product

The following table shows our components of revenue and their respective percentages of total revenue for the periods indicated (in thousands except percentage):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues				
Service	$127,810	$97,529	$373,932	$292,634
Product	4,705	4,824	15,276	15,301
Insurance	4,023	4,099	12,684	12,932
Customized postage	6,957	8,588	14,755	15,306
Other	12	22	52	69
Total revenues	$143,507	$115,062	$416,699	$336,242
Revenue as a percentage of total revenues				
Service	89.1 %	84.8 %	89.7 %	87.0 %
Product	3.3 %	4.2 %	3.7 %	4.6 %
Insurance	2.8 %	3.5 %	3.1 %	3.8 %
Customized postage	4.8 %	7.5 %	3.5 %	4.6 %
Other	0.0 %	0.0 %	0.0 %	0.0 %
Total revenue	100.0 %	100.0 %	100.0 %	100.0 %

Our revenue is derived primarily from five sources: (1) service and transaction related revenues from our USPS mailing and shipping services, our multi-carrier shipping services and our mailing and shipping integrations; (2) product revenue from the direct sale of consumables and supplies through our Supplies Stores; (3) package insurance revenue from our branded insurance offerings; (4) customized postage revenue from the sale of customized postage labels; and (5) other revenue, consisting of advertising revenue derived from advertising programs with our existing customers.

We earn service revenue from our mailing and shipping operations in several different ways: (1) customers may pay us a monthly fee based on a subscription plan which may be waived or refunded for certain customers; (2) we may be compensated directly by the USPS for certain qualifying customers under our USPS partnership; (3) we may earn transaction related revenue based on customers purchasing postage or printing shipping labels; (4) we may earn compensation by offering customers a discounted postage rate that is provided to the customers by our integration partners; and (5) we may earn other types of revenue shares or other compensation from specific customers or integration partners.

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Service revenue increased 31% to $127.8 million in the three months ended September 30, 2018 from $97.5 million in the three months ended September 30, 2017. Service revenue increased 28% to $373.9 million in the nine months ended September 30, 2018 from $292.6 million in the nine months ended September 30, 2017. The increase in service revenue during the three months ended September 30, 2018 was driven by a 32% increase in our average service revenue per paid customer (Service Revenue ARPU), partially offset by a 0.5% decrease in paid customers.

The increase in our Service Revenue ARPU during the three months ended September 30, 2018 was primarily attributable to the factors that resulted in an increase in the average total mailing and shipping revenue per paid customer described in the previous section.

Product revenue decreased 2% to $4.7 million in the three months ended September 30, 2018 from $4.8 million in the three months ended September 30, 2017. Product revenue was $15.3 million in both the nine months ended September 30, 2018 and the nine months ended September 30, 2017. Product revenue is primarily driven by labels, such as NetStamps and DYMO Stamps, which are used for mailing. As our growth in postage has been driven more by shipping than mailing over the recent years, our product revenue has not kept pace with our growth in total revenue.

Insurance revenue decreased 2% to $4.0 million in the three months ended September 30, 2018 from $4.1 million in the three months ended September 30, 2017. Insurance revenue decreased 2% to $12.7 million in the nine months ended September 30, 2018 from $12.9 million in the nine months ended September 30, 2017. Our insurance revenue decreased year over year despite the growth in service revenue related to high volume shipper customers. High volume shipper customers often self-insure, so while the high volume shipping business results in higher service fee revenue, it may not result in higher insurance revenue.

Customized postage revenue decreased 19% to $7.0 million in the three months ended September 30, 2018 from $8.6 million in the three months ended September 30, 2017. Customized postage revenue decreased 4% to $14.8 million in the nine months ended September 30, 2018 from $15.3 million in the nine months ended September 30, 2017. The decrease was primarily attributable to decreases in high volume customer orders. High volume order sales are unpredictable and vary from quarter to quarter.

Cost of Revenue

The following table shows cost of revenues and cost of revenues as a percentage of associated revenue for the periods indicated (in thousands except percentage):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of revenues				
Service	25,102	11,882	68,361	37,284
Product	1,383	1,535	4,614	4,930
Insurance	933	966	2,945	3,547
Customized postage	5,706	7,151	12,173	12,600
Total cost of revenues	$33,124	$21,534	$88,093	$58,361
Cost as percentage of associated revenue				
Service	19.6 %	12.2 %	18.3 %	12.7 %
Product	29.4 %	31.8 %	30.2 %	32.2 %
Insurance	23.2 %	23.6 %	23.2 %	27.4 %
Customized postage	82.0 %	83.3 %	82.5 %	82.3 %

Total cost as a percentage of total revenues	23.1 %	18.7 %	21.1 %	17.4 %

Cost of service revenue principally consists of the cost of customer service, certain promotional expenses, system operating costs, credit card processing fees, vendor costs and expenses, and customer misprints that do not qualify for reimbursement from the USPS. Cost of product revenue principally consists of the cost of products sold through our Supplies Stores and the related costs of shipping and handling. The cost of insurance revenue principally consists of parcel insurance offering costs through our third party insurance providers. Cost of customized postage revenue principally consists of the face value of postage, customer service, image review costs, and printing and fulfillment costs.

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Cost of service revenue increased 111% to $25.1 million in the three months ended September 30, 2018 from $11.9 million in the three months ended September 30, 2017. Cost of service revenue increased 83% to $68.4 million in the nine months ended September 30, 2018 from $37.3 million in the nine months ended September 30, 2017. The increase during the three months ended September 30, 2018 was primarily attributable to (1) a $7.3 million increase in vendor costs and expenses in connection with services for which we include such costs and expenses both in revenue and in cost of service revenue; (2) higher system operating and customer service costs, which increased by $3.2 million, to support our growing business, (3) higher credit card processing fees, which increased by $1.7 million, directly related to our higher revenue; and (4) MetaPack cost of service revenue of $0.8 million. The increase during the nine months ended September 30, 2018 was primarily attributable to (1) an $18.7 million increase in vendor costs and expenses in connection with services for which we include such costs and expenses both in revenue and in cost of service revenue; (2) higher system operating and customer service costs, which increased by $6.1 million, to support our growing business; (3) higher credit card processing fees, which increased by $5.4 million, directly related to our higher revenue; and (4) MetaPack cost of service revenue of $0.8 million. Promotional expenses were not material in the three and nine months ended September 30, 2018 and 2017.

Cost of service revenue as a percent of service revenue increased to 20% in the three months ended September 30, 2018 from 12% in the three months ended September 30, 2017. Cost of service revenue as a percent of service revenue increased to 18% in the nine months ended September 30, 2018 from 13% in the nine months ended September 30, 2017. The increase is primarily attributable to the relative increase in service revenue from service offerings for which the vendor costs and expenses are included both in revenue and in cost of service revenue.

Cost of product revenue decreased 10% to $1.4 million in the three months ended September 30, 2018 from $1.5 million in the three months ended September 30, 2017. Cost of product revenue decreased 6% to $4.6 million in the nine months ended September 30, 2018 from $4.9 million in the nine months ended September 30, 2017. The decrease during the three and nine months ended September 30, 2018 was primarily attributable to lower costs of sale for NetStamps labels.

Cost of product revenue as a percent of product revenue decreased to 29% in the three months ended September 30, 2018 from 32% in the three months ended September 30, 2017. Cost of product revenue as a percent of product revenue decreased to 30% in the nine months ended September 30, 2018 from 32% in the nine months ended September 30, 2017. The decrease is primarily attributable to lower costs of sale for NetStamps labels.

Cost of insurance revenue decreased 3% to $0.9 million in the three months ended September 30, 2018 from $1.0 million in the three months ended September 30, 2017. Cost of insurance revenue decreased 17% to $2.9 million in the nine months ended September 30, 2018 from $3.5 million in the nine months ended September 30, 2017. The decrease was primarily attributable to lower cost as a result of a renegotiated contract.

Cost of insurance revenue as a percent of insurance revenue decreased to 23% in the three months ended September 30, 2018 from 24% in the three months ended