BLACKBAUD INC
Form 10-Q
August 04, 2016

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

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .
Commission file number: 000-50600

Blackbaud, Inc.
(Exact name of registrant as specified in its charter)

Delaware	11-2617163
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2000 Daniel Island Drive
Charleston, South Carolina 29492
(Address of principal executive offices, including zip code)
(843) 216-6200
(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 þ 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 (Section 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 þ NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES ¨ NO þ
The number of shares of the registrant’s Common Stock outstanding as of July 25, 2016 was 47,518,682.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the documents incorporated herein by reference, contains forward-looking statements that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These "forward-looking statements" are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our anticipated growth, the effect of general economic and market conditions, our business strategy and our plan to build and grow our business, our operating results, our ability to successfully integrate acquired businesses and technologies, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the impact of expensing stock-based compensation, the sufficiency of our capital resources, our ability to meet our ongoing debt and obligations as they become due, and potential litigation involving us, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as “believes,” “seeks,” “expects,” “may,” “might,” “should,” “intends,” “could,” “would,” “likely,” “will,” “targets,” “plans,” “anticipates,” “aims,” “projects,” “estimates” or any such words and similar expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Accordingly, they should not be viewed as assurances of future performance, and actual results may differ materially and adversely from those expressed in any forward-looking statements.

Important factors that could cause actual results to differ materially from our expectations expressed in forward-looking statements include, but are not limited to, those summarized under “Item 1A. Risk factors” and elsewhere in this report, in our Annual Report on Form 10-K for the year ended December 31, 2015 and in our other SEC filings. Forward-looking statements represent our management's beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update or revise any forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in any forward-looking statement, whether as a result of new information, future events or otherwise.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Blackbaud, Inc.
Consolidated Balance Sheets
(Unaudited)

(dollars in thousands)	June 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$15,263	$15,362
Restricted cash due to customers	195,034	255,038
Accounts receivable, net of allowance of $4,386 and $4,943 at June 30, 2016 and December 31, 2015, respectively	107,749	80,046
Prepaid expenses and other current assets	53,797	48,666
Total current assets	371,843	399,112
Property and equipment, net	54,144	52,651
Software development costs, net	27,793	19,551
Goodwill	436,012	436,449
Intangible assets, net	273,445	294,672
Other assets	21,847	20,901
Total assets	$1,185,084	$1,223,336
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	$27,817	$19,208
Accrued expenses and other current liabilities	44,739	57,461
Due to customers	195,034	255,038
Debt, current portion	4,375	4,375
Deferred revenue, current portion	250,449	230,216
Total current liabilities	522,414	566,298
Debt, net of current portion	398,865	403,712
Deferred tax liability	27,823	27,996
Deferred revenue, net of current portion	6,212	7,119
Other liabilities	8,102	7,623
Total liabilities	963,416	1,012,748
Commitments and contingencies (see Note 10)		
Stockholders' equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, $0.001 par value; 180,000,000 shares authorized, 57,543,656 and 56,873,817 shares issued at June 30, 2016 and December 31, 2015, respectively	58	57
Additional paid-in capital	294,810	276,340
Treasury stock, at cost; 10,048,472 and 9,903,071 shares at June 30, 2016 and December 31, 2015, respectively	(207,898)	(199,861)
Accumulated other comprehensive loss	(1,640)	(825)
Retained earnings	136,338	134,877
Total stockholders' equity	221,668	210,588
Total liabilities and stockholders' equity	$1,185,084	$1,223,336

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

Blackbaud, Inc.
Consolidated statements of comprehensive income
(Unaudited)

(dollars in thousands, except per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenue				
Subscriptions	$104,039	$80,009	$200,890	$152,522
Maintenance	37,449	38,627	74,609	77,523
Services	35,419	33,667	67,833	64,973
License fees and other	3,284	3,956	6,115	8,234
Total revenue	180,191	156,259	349,447	303,252
Cost of revenue				
Cost of subscriptions	52,142	39,400	101,814	75,578
Cost of maintenance	5,685	6,969	11,008	14,471
Cost of services	24,696	25,915	49,015	52,886
Cost of license fees and other	1,020	1,146	1,622	2,307
Total cost of revenue	83,543	73,430	163,459	145,242
Gross profit	96,648	82,829	185,988	158,010
Operating expenses				
Sales, marketing and customer success	39,308	29,723	74,922	58,285
Research and development	22,578	20,166	45,357	41,442
General and administrative	19,857	17,955	39,613	34,798
Amortization	708	524	1,460	1,012
Total operating expenses	82,451	68,368	161,352	135,537
Income from operations	14,197	14,461	24,636	22,473
Interest expense	(2,721)	(1,873)	(5,396)	(3,559)
Other expense, net	(65)	(1,274)	(170)	(1,561)
Income before provision for income taxes	11,411	11,314	19,070	17,353
Income tax provision	3,598	4,272	6,262	6,026
Net income	$7,813	$7,042	$12,808	$11,327
Earnings per share				
Basic	$0.17	$0.15	$0.28	$0.25
Diluted	$0.17	$0.15	$0.27	$0.24
Common shares and equivalents outstanding				
Basic weighted average shares	46,083,055	45,579,345	46,047,788	45,554,645
Diluted weighted average shares	46,927,626	46,402,707	46,865,218	46,289,440
Dividends per share	$0.12	$0.12	$0.24	$0.24
Other comprehensive (loss) income				
Foreign currency translation adjustment	(431)	(196)	(28)	(522)
Unrealized (loss) gain on derivative instruments, net of tax	(118)	97	(787)	(372)
Total other comprehensive loss	(549)	(99)	(815)	(894)
Comprehensive income	$7,264	$6,943	$11,993	$10,433

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

Blackbaud, Inc.
Consolidated statements of cash flows
(Unaudited)

(dollars in thousands)	Six months ended June 30, 2016	2015
Cash flows from operating activities		
Net income	$12,808	$11,327
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35,549	27,272
Provision for doubtful accounts and sales returns	2,264	2,934
Stock-based compensation expense	15,787	11,413
Excess tax benefits from exercise and vesting of stock-based compensation	(2,729)	(954)
Deferred taxes	(129)	(801)
Loss on sale of business	—	1,976
Amortization of deferred financing costs and discount	478	420
Other non-cash adjustments	(429)	289
Changes in operating assets and liabilities, net of acquisition and disposal of businesses:		
Accounts receivable	(30,097)	(13,355)
Prepaid expenses and other assets	(6,011)	(2,102)
Trade accounts payable	8,857	5,235
Accrued expenses and other liabilities	(18,019)	(9,882)
Restricted cash due to customers	62,038	78,718
Due to customers	(62,038)	(78,718)
Deferred revenue	19,658	13,792
Net cash provided by operating activities	37,987	47,564
Cash flows from investing activities		
Purchase of property and equipment	(12,569)	(7,014)
Capitalized software development costs	(12,168)	(6,982)
Purchase of net assets of acquired companies, net of cash	530	—
Net cash used in sale of business	—	(521)
Net cash used in investing activities	(24,207)	(14,517)
Cash flows from financing activities		
Proceeds from issuance of debt	120,900	70,100
Payments on debt	(126,088)	(93,388)
Proceeds from exercise of stock options	5	18
Excess tax benefits from exercise and vesting of stock-based compensation	2,729	954
Dividend payments to stockholders	(11,398)	(11,255)
Net cash used in financing activities	(13,852)	(33,571)
Effect of exchange rate on cash and cash equivalents	(27)	(984)
Net decrease in cash and cash equivalents	(99)	(1,508)
Cash and cash equivalents, beginning of period	15,362	14,735
Cash and cash equivalents, end of period	$15,263	$13,227

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

Blackbaud, Inc.
Consolidated statements of stockholders' equity
(Unaudited)

(dollars in thousands)	Common stock Shares	Common stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive loss	Retained earnings	Total stockholders' equity
Balance at December 31, 2014	56,048,135	$ 56	$ 245,674	$ (190,440)	$ (1,032)	$ 131,658	$ 185,916
Net income	—	—	—	—	—	25,649	25,649
Payment of dividends	—	—	—	—	—	(22,508)	(22,508)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	202,078	—	32	—	—	—	32
Surrender of 163,017 shares upon vesting of restricted stock and restricted stock units and exercise of stock appreciation rights	—	—	—	(9,421)	—	—	(9,421)
Excess tax benefits from exercise and vesting of stock-based compensation	—	—	5,466	—	—	—	5,466
Stock-based compensation	—	—	25,168	—	—	78	25,246
Restricted stock grants	736,252	1	—	—	—	—	1
Restricted stock cancellations	(112,648)	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	207	—	207
Balance at December 31, 2015	56,873,817	$ 57	$ 276,340	$ (199,861)	$ (825)	$ 134,877	$ 210,588
Net income	—	—	—	—	—	12,808	12,808
Payment of dividends	—	—	—	—	—	(11,398)	(11,398)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	225,653	—	5	—	—	—	5
Surrender of 145,401 shares upon vesting of restricted stock and restricted stock units and exercise of stock appreciation rights	—	—	—	(8,037)	—	—	(8,037)
Excess tax benefits from exercise and vesting of stock-based compensation	—	—	2,729	—	—	—	2,729
Stock-based compensation	—	—	15,736	—	—	51	15,787
Restricted stock grants	510,936	1	—	—	—	—	1
Restricted stock cancellations	(66,750)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(815)	—	(815)
Balance at June 30, 2016	57,543,656	$ 58	$ 294,810	$ (207,898)	$ (1,640)	$ 136,338	$ 221,668

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

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Blackbaud, Inc.
Notes to consolidated financial statements
(Unaudited)

1. Organization

We are the world’s leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, corporations, education institutions, and individual change agents—we connect and empower organizations to increase their impact through software, services, expertise, and data intelligence. Our portfolio is tailored to the unique needs of vertical markets, with solutions for fundraising and relationship management, digital marketing, advocacy, accounting, payments, analytics, school management, grant management, corporate social responsibility and volunteerism. Serving the industry for more than three decades, we are headquartered in Charleston, South Carolina and have operations in the United States, Australia, Canada, Ireland and the United Kingdom. As of June 30, 2016, we had approximately 35,000 active customers.

2. Summary of Significant Accounting Policies

Unaudited interim consolidated financial statements

The accompanying interim consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statements of cash flows and consolidated statements of stockholders’ equity, for the periods presented in accordance with accounting principles generally accepted in the United States ("GAAP"). The consolidated balance sheet at December 31, 2015, has been derived from the audited consolidated financial statements at that date. Operating results and cash flows for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2016, or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015, and other forms filed with the SEC from time to time.

Reclassifications

In order to provide comparability between periods presented, "interest income", "loss on sale of business", "loss on debt extinguishment and termination of derivative instruments" and "other income (expense), net" have been combined within "other expense, net" in the previously reported consolidated statements of comprehensive income to conform to presentation of the current period. See Note 7 to these consolidated financial statements for additional details.

Basis of consolidation

The consolidated financial statements include the accounts of Blackbaud, Inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, we reconsider and evaluate our estimates and assumptions, including those that impact revenue recognition, long-lived and intangible assets including goodwill, stock-based compensation, the provision for income taxes, deferred taxes, capitalization of software development costs and related amortization, our allowances for sales returns and doubtful accounts, deferred sales commissions and professional services costs, valuation

of derivative instruments, accounting for business combinations and loss contingencies. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could materially differ from these estimates.

Revenue recognition

Our revenue is primarily generated from the following sources: (i) charging for the use of our software solutions in cloud-based and hosted environments; (ii) providing software maintenance and support services; (iii) providing professional services including implementation, training, consulting, analytic, hosting and other services; (iv) providing transaction and payment processing services; and (v) selling perpetual licenses of our software solutions.

We recognize revenue when all of the following conditions are met:

•Persuasive evidence of an arrangement exists;

•The solutions or services have been delivered;

•The fee is fixed or determinable; and

•Collection of the resulting receivable is probable.

Determining whether and when these criteria have been met can require significant judgment and estimates. We deem acceptance of a contract to be evidence of an arrangement. Delivery of our services occurs when the services have been performed. Delivery of our solutions occurs when the solution is shipped or transmitted, and title and risk of loss have transferred to the customers. Our typical arrangements do not include customer acceptance provisions; however, if acceptance provisions are provided, delivery is deemed to occur upon acceptance. We consider the fee to be fixed or determinable unless the fee is subject to refund or adjustment or is not payable within our standard payment terms. Payment terms greater than 90 days are considered to be beyond our customary payment terms. Collection is deemed probable if we expect that the customer will be able to pay amounts under the arrangement as they become due. If we determine that collection is not probable, we defer revenue recognition until collection. Revenue is recognized net of actual and estimated sales returns and allowances.

We follow guidance provided in ASC 605-45, Principal Agent Considerations, which states that determining whether a company should recognize revenue based on the gross amount billed to a customer or the net amount retained is a matter of judgment that depends on the facts and circumstances of the arrangement and that certain factors should be considered in the evaluation.

Subscriptions

We provide software solutions to customers which are available for use in cloud-based subscription arrangements without licensing perpetual rights to the software (“cloud-based solutions”). Revenue from cloud-based solutions is recognized ratably beginning on the activation date over the term of the agreement, which generally ranges from one to three years. Any revenue related to upfront activation or set-up fees is deferred and recognized ratably over the estimated period that the customer benefits from the related cloud-based solution. Direct and incremental costs related to upfront activation or set-up activities for cloud-based solutions are capitalized until the cloud-based solution is deployed and in use, and then expensed ratably over the estimated period that the customer benefits from the related cloud-based solution.

We provide hosting services to customers who have purchased perpetual rights to certain of our software solutions (“hosting services”). Revenue from hosting services, online training programs as well as subscription-based analytic services such as data enrichment and data management services, is recognized ratably beginning on the activation date over the term of the agreement, which generally ranges from one to three years. Any related set-up fees are recognized ratably over the estimated period that the customer benefits from the related hosting service. The estimated period of benefit is evaluated on an annual basis using historical customer retention information by solution or service.

For arrangements that have multiple elements and do not include software licenses, we allocate arrangement consideration at the inception of the arrangement to those elements that qualify as separate units of accounting. The arrangement consideration is allocated to the separate units of accounting based on relative selling price method in accordance with

Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

the selling price hierarchy, which includes: (i) vendor specific objective evidence ("VSOE") of fair value if available; (ii) third-party evidence ("TPE") if VSOE is not available; and (iii) best estimate of selling price ("BESP") if neither VSOE nor TPE is available. In general, we use VSOE to allocate the selling price to subscription and service deliverables.

We offer certain payment processing services with the assistance of third-party vendors. In general, when we are the principal in a transaction based on the predominant weighting of factors identified in ASC 605-45, we record the revenue and related costs on a gross basis. Otherwise, we net the cost of revenue associated with the service against the gross amount billed to the customer and record the net amount as revenue.

Revenue from transaction processing services is recognized when the service is provided and the amounts are determinable. Revenue directly associated with processing donations for customers are included in subscriptions revenue.

Maintenance

We recognize revenue from maintenance services ratably over the term of the arrangement, generally one year at contract inception with annual renewals thereafter. Maintenance contracts are at rates that vary according to the level of the maintenance program associated with the software solution and are generally renewable annually. Maintenance contracts may also include the right to unspecified solution upgrades on an if-and-when available basis. Certain incremental support services are sold in prepaid units of time and recognized as revenue upon their usage.

Services

We generally bill consulting, installation and implementation services based on hourly rates plus reimbursable travel-related expenses. Revenue is recognized for these services over the period the services are delivered.

We recognize analytic services revenue from donor prospect research engagements, the sale of lists of potential donors, benchmarking studies and data modeling service engagements upon delivery. In arrangements where we provide customers the right to updated information during the contract period, revenue is recognized ratably over the contract period.

We sell fixed-rate programs, which permit customers to attend unlimited training over a specified contract period, typically one year, subject to certain restrictions, and revenue in those cases is recognized ratably over the contract period. Additionally, we sell training at a fixed rate for each specific class at a per attendee price or at a packaged price for several attendees, and recognize the related revenue upon the customer attending and completing training.

License fees

We sell perpetual software licenses with maintenance, varying levels of professional services and, in certain instances, with hosting services. We allocate revenue to each of the elements in these arrangements using the residual method under which we first allocate revenue to the undelivered elements, typically the non-software license components, based on VSOE of fair value of the various elements. We determine VSOE of fair value of the various elements using different methods. VSOE of fair value for maintenance services associated with software licenses is based upon renewal rates stated in the arrangements with customers, which demonstrate a consistent relationship of maintenance pricing as a percentage of the contractual license fee. VSOE of fair value of professional services and other solutions and services is based on the average selling price of these same solutions and services to other customers when sold on a stand-alone basis. Any remaining revenue is allocated to the delivered elements, which is normally the software license in the arrangement. In general, revenue is recognized for software licenses upon delivery to our customers.

When a software license is sold with software customization services, generally the services are to provide the customer assistance in creating special reports and other enhancements that will improve operational efficiency and/or help to support business process improvements. These services are generally not essential to the functionality of the software and the related revenues are recognized either as the services are delivered or upon completion. However, when software customization services are considered essential to the functionality of the software, we recognize revenue for both the software license and the services using the percentage-of-completion method.

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Notes to consolidated financial statements (continued)
(Unaudited)

Deferred revenue

To the extent that our customers are billed for the above described solutions and services in advance of delivery, we record such amounts in deferred revenue. Generally, our subscription and maintenance customers are billed one year in advance.

Fair value measurements

We measure certain financial assets and liabilities at fair value on a recurring basis, including derivative instruments. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. An active market is defined as a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. We use a three-tier fair value hierarchy to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets;
- Level 2 - Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3 - Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

Our financial assets and liabilities are classified in their entirety within the hierarchy based on the lowest level of input that is significant to fair value measurement. Changes to a financial asset's or liability's level within the fair value hierarchy are determined as of the end of a reporting period. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

Earnings per share

We compute basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common shares outstanding during the period. Diluted earnings per share reflect the assumed exercise, settlement and vesting of all dilutive securities using the “treasury stock method” except when the effect is anti-dilutive. Potentially dilutive securities consist of shares issuable upon the exercise of stock options, settlement of stock appreciation rights and vesting of restricted stock awards and units.

Recently adopted accounting pronouncements

In September 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-16, Simplifying the Accounting for Measurement-Period Adjustments (ASU 2015-16). ASU 2015-16 requires for acquirers in business combinations to recognize adjustments to provisional amounts identified during measurement periods in the reporting periods in which adjusted amounts are determined. The update requires that acquirers record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization or other income effects, if any, resulting from changes in provisional amounts, calculated as if the accounting had been completed at acquisition date. The update also requires separate income statement presentation or note disclosure of amounts recorded in current period earnings by line item that would have been recorded in previous reporting periods if the provisional amount adjustments had been recognized at the acquisition date (requirements to retrospectively account for those adjustments have been eliminated). The guidance is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Amendments in this update should be applied prospectively to adjustments to provisional amounts that occur after its effective date, with earlier application permitted for financial statements that have not been issued. We adopted ASU 2015-16 on January 1, 2016. See Note 3 to these consolidated financial statements for details of any immaterial measurement period adjustments.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) - Customer's Accounting for Fees Paid in a Cloud Computing Arrangement (ASU 2015-05). The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the update specifies that the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. The update further specifies that the customer should account for a cloud computing arrangement as a service contract if the arrangement does not include a software license. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. We adopted ASU 2015-05 on January 1, 2016 on a prospective basis and it did not have a material impact on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest - Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03). ASU 2015-03 sets forth a requirement that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by the amendments in this update. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effects of applying the new guidance. We adopted ASU 2015-03 on January 1, 2016 and retrospectively restated "other assets" and "debt, net of current portion", which had the effect of reducing each of those respective line items in our December 31, 2015 consolidated balance sheet by approximately $0.5 million.

Recently issued accounting pronouncements

In March 2016, the FASB issued ASU 2016-09, Compensation — Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). ASU 2016-09 updates the accounting for certain aspects of share-based payments to employees. Entities will be required to recognize the income tax effects of awards in the income statement when the awards vest or are settled. The guidance also updates an employers' accounting for an employee's use of shares to satisfy the employer's statutory income tax withholding obligation and accounting for forfeitures. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted but all of the guidance must be adopted in the same period. We expect ASU 2016-09 will impact our consolidated balance sheets, statements of comprehensive income and cash flows, and we are currently evaluating the extent of the impact that implementation of this standard will have on adoption. We are currently considering early adopting this new guidance during 2016.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (ASU 2016-02). ASU 2016-02 will require lessees to record most leases on their balance sheets but recognize expenses in the income statement in a manner similar to current guidance. The updated guidance also eliminates certain real estate-specific provisions and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs for all entities. For lessors, the standard modifies the classification criteria and the accounting for sales-type and direct financing leases. All entities will classify leases to determine how to recognize lease-related revenue and expense. Classification will continue to affect amounts that lessors record on the balance sheet. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted. Upon adoption, entities will be required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. We expect ASU 2016-02 will impact our consolidated financial statements and are currently evaluating the extent of the impact that implementation of this standard will have on adoption.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09). ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 was originally effective for fiscal years and interim periods within those years beginning after December 15, 2016. An entity should apply ASU 2014-09 either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized as an adjustment to the opening balance of retained earnings at the date of initial application. In July, 2015, the FASB decided to delay the effective date of the new standard for one year. The new standard now requires application no later than annual reporting periods beginning after December 15, 2017, including interim reporting periods therein; however, public entities are permitted to elect to early adopt the new standard as of the original effective date. In March 2016, the FASB finalized amendments to the guidance in the new

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standard to clarify whether an entity is a principal or an agent in a revenue transaction. In April 2016, the FASB finalized additional amendments to the guidance in the new standard to clarify the accounting for licenses of intellectual property and identifying performance obligations. We expect the adoption of ASU 2014-09 will impact our consolidated financial statements. We are currently evaluating implementation methods and the extent of the impact that implementation of this standard and the recently issued clarifying amendments will have upon adoption.

3. Business Combinations

2015 Acquisitions

Smart Tuition

On October 2, 2015, we completed our acquisition of all of the outstanding equity, including all voting equity interests, of Smart, LLC (“Smart Tuition”). Smart Tuition is a leading provider of payment software and services for private schools and parents. The acquisition of Smart Tuition further expanded our offerings in the K-12 technology sector. We acquired Smart Tuition for $187.3 million in cash, net of closing adjustments including an adjustment of approximately $0.5 million during the three months ended March 31, 2016. We received the proceeds from these closing adjustments during the three months ended June 30, 2016. On October 2, 2015, we drew down a $186.0 million revolving credit loan under our 2014 Credit Facility (as defined in Note 8 below) to finance the acquisition of Smart Tuition. As a result of the acquisition, Smart Tuition has become a wholly-owned subsidiary of ours. We included the operating results of Smart Tuition as well as goodwill arising from the acquisition in our consolidated financial statements within the General Markets Business Unit ("GMBU") from the date of acquisition. For the three months ended June 30, 2016, Smart Tuition's total revenue and operating income included in our consolidated financial statements was $8.2 million and $0.6 million, respectively. For the six months ended June 30, 2016, Smart Tuition's total revenue and operating income included in our consolidated financial statements was $17.4 million and $1.8 million, respectively.

The preliminary purchase price allocation is based upon a preliminary valuation of assets and liabilities and the estimates and assumptions are subject to change as we obtain additional information during the measurement period, which may be up to one year from the acquisition date. The assets and liabilities pending finalization include the valuation of acquired intangible assets, the assumed deferred revenue and deferred taxes. Differences between the preliminary and final valuation could have a material impact on our future results of operations and financial position.

The following table summarizes the preliminary allocation of the purchase price based on the estimated fair value of the assets acquired and the liabilities assumed:

(dollars in thousands)	Purchase Price Allocation
Net working capital, excluding deferred revenue	$ 276
Property and equipment	2,457
Deferred revenue	(6,500)
Deferred tax asset	2,637
Intangible assets	97,800
Goodwill	90,302
Total purchase price[(1)]	$ 186,972

(1) The purchase price differs from the net cash outlay of $187.3 million due to certain insignificant acquisition-related expenses included therein.

The estimated fair value of accounts receivable acquired approximates the contractual value of $2.8 million. The estimated goodwill recognized is attributable primarily to the opportunities for expected synergies from combining operations and the assembled workforce of Smart Tuition, all of which was assigned to our GMBU reporting segment. Approximately $86.2 million of the goodwill arising in the acquisition is deductible for income tax purposes.

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The Smart Tuition acquisition resulted in the identification of the following identifiable intangible assets:

	Intangible assets acquired (in thousands)	Weighted average amortization period (in years)
Customer relationships	$ 72,300	17
Marketing assets	1,200	3
Acquired technology	22,100	7
Non-compete agreements	2,200	5
Total intangible assets	$ 97,800	14

The estimated fair values of the finite-lived intangible assets were based on variations of the income approach, which estimates fair value based on the present value of cash flows that the assets are expected to generate which included the relief-from-royalty method, incremental cash flow method including the with and without method and excess earnings method, depending on the intangible asset being valued. The method of amortization of identifiable finite-lived intangible assets is based on the expected pattern in which the estimated economic benefits of the respective assets are consumed or otherwise used up. Customer relationships and acquired technology are being amortized on an accelerated basis while marketing assets and non-compete agreements are being amortized on a straight-line basis.

The following unaudited pro forma condensed combined consolidated results of operations assume that the acquisition of Smart Tuition occurred on January 1, 2014. This unaudited pro forma financial information does not reflect any adjustments for anticipated synergies resulting from the acquisition and should not be relied upon as being indicative of the historical results that would have been attained had the transaction been consummated as of January 1, 2014, or of the results that may occur in the future. The unaudited pro forma information reflects adjustments for amortization of intangibles related to the fair value adjustments of the assets acquired, write-down of acquired deferred revenue to fair value, additional interest expense related to the financing of the transaction and the related tax effects of the adjustments.

(dollars in thousands, except per share amounts)	Three months ended June 30, 2015	Six months ended June 30, 2015
Revenue	$164,170	$319,982
Net income	$6,084	$10,523
Basic earnings per share	$0.13	$0.23
Diluted earnings per share	$0.13	$0.23

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4. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands, except per share amounts)	2016	2015	2016	2015
Numerator:				
Net income	$7,813	$ 7,042	$12,808	$ 11,327
Denominator:				
Weighted average common shares	46,083,055	45,579,345	46,047,786	45,554,645
Add effect of dilutive securities:				
Stock-based compensation	844,571	823,362	817,430	734,795
Weighted average common shares assuming dilution	46,927,626	46,402,707	46,865,216	46,289,440
Earnings per share:				
Basic	$0.17	$ 0.15	$0.28	$ 0.25
Diluted	$0.17	$ 0.15	$0.27	$ 0.24

The following shares underlying stock-based awards were not included in diluted earnings per share because their inclusion would have been anti-dilutive:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Shares excluded from calculations of diluted earnings per share	—	12,705	44,134	10,152

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5. Fair Value Measurements

Recurring fair value measurements

Financial assets and liabilities measured at fair value on a recurring basis consisted of the following, as of:

(dollars in thousands)	Fair value measurement using Level 1	Level 2	Level 3	Total
Fair value as of June 30, 2016				
Financial liabilities:				
Derivative instruments(1)	$ —	$ 1,329	$ —	$ 1,329
Total financial liabilities	$ —	$ 1,329	$ —	$ 1,329
Fair value as of December 31, 2015				
Financial assets:				
Derivative instruments(1)	$ —	$ 406	$ —	$ 406
Total financial assets	$ —	$ 406	$ —	$ 406
Fair value as of December 31, 2015				
Financial liabilities:				
Derivative instruments(1)	$ —	$ 438	$ —	$ 438
Total financial liabilities	$ —	$ 438	$ —	$ 438

(1) The fair value of our interest rate swaps was based on model-driven valuations using LIBOR rates, which are observable at commonly quoted intervals. Accordingly, our interest rate swaps are classified within Level 2 of the fair value hierarchy.

We believe the carrying amounts of our cash and cash equivalents, restricted cash due to customers, accounts receivable, trade accounts payable, accrued expenses and other current liabilities and due to customers approximate their fair values at June 30, 2016 and December 31, 2015, due to the immediate or short-term maturity of these instruments.

We believe the carrying amount of our debt approximates its fair value at June 30, 2016 and December 31, 2015, as the debt bears interest rates that approximate market value. As LIBOR rates are observable at commonly quoted intervals, our debt is classified within Level 2 of the fair value hierarchy.

Non-recurring fair value measurements

Assets and liabilities that are measured at fair value on a non-recurring basis include intangible assets and goodwill which are recognized at fair value during the period in which an acquisition is completed, from updated estimates and assumptions during the measurement period, or when they are considered to be impaired. These non-recurring fair value measurements, primarily for intangible assets acquired, were based on Level 3 unobservable inputs. In the event of an impairment, we determine the fair value of the goodwill and intangible assets using a discounted cash flow approach, which contains significant unobservable inputs and therefore is considered a Level 3 fair value measurement. The unobservable inputs in the analysis generally include future cash flow projections and a discount rate.

There were no non-recurring fair value adjustments to intangible assets and goodwill during the six months ended June 30, 2016, except for certain insignificant business combination accounting adjustments to the initial fair value estimates of the Smart Tuition assets acquired and liabilities assumed at the acquisition date from updated information obtained during the measurement period. See Note 3 to these consolidated financial statements for additional details. The measurement period may be up to one year from the acquisition date. We record any measurement period adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill.

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6. Goodwill and Other Intangible Assets

The change in goodwill for each reportable segment (as defined in Note 14 below) during the six months ended June 30, 2016, consisted of the following:

(dollars in thousands)	ECBU	GMBU	IBU	Total
Balance at December 31, 2015	$240,494	$190,976	$4,979	$436,449
Adjustments related to prior year business combinations[1]	—	(256)	—	(256)
Effect of foreign currency translation	—	—	(181)	(181)
Balance at June 30, 2016	$240,494	$190,720	$4,798	$436,012

(1) See Note 3 to these consolidated financial statements for details of certain of the immaterial measurement period adjustments.

Amortization expense

Amortization expense related to finite-lived intangible assets acquired in business combinations is allocated to cost of revenue on the consolidated statements of comprehensive income based on the revenue stream to which the asset contributes, except for marketing assets and non-compete agreements, for which the associated amortization expense is included in operating expenses.

The following table summarizes amortization expense:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2016	2015	2016	2015
Included in cost of revenue:				
Cost of subscriptions	$7,853	$5,767	$15,664	$11,539
Cost of maintenance	1,332	1,006	2,664	2,159
Cost of services	657	702	1,310	1,309
Cost of license fees and other	85	92	170	199
Total included in cost of revenue	9,927	7,567	19,808	15,206
Included in operating expenses	708	524	1,460	1,012
Total amortization of intangibles from business combinations	$10,635	$8,091	$21,268	$16,218

The following table outlines the estimated future amortization expense for each of the next five years for our finite-lived intangible assets as of June 30, 2016:

(dollars in thousands) Years ending December 31,	Amortization expense
2016 - remaining	$ 20,991
2017	41,426
2018	39,788
2019	36,479
2020	27,701
Total	$ 166,385

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7. Consolidated Financial Statement Details

Prepaid expenses and other assets

(dollars in thousands)	June 30, 2016	December 31, 2015
Deferred sales commissions	$34,027	$ 30,141
Prepaid software maintenance	20,670	15,308
Deferred professional services costs	2,586	3,603
Taxes, prepaid and receivable	6,398	9,121
Deferred tax asset	3,385	2,869
Prepaid royalties	1,442	1,767
Other assets	7,136	6,758
Total prepaid expenses and other assets	75,644	69,567
Less: Long-term portion	21,847	20,901
Prepaid expenses and other current assets	$53,797	$ 48,666

Accrued expenses and other liabilities

(dollars in thousands)	June 30, 2016	December 31, 2015
Accrued bonuses	$11,979	$ 24,591
Accrued commissions and salaries	8,371	8,391
Taxes payable	4,523	3,923
Deferred rent liabilities	4,108	4,070
Lease incentive obligations	4,306	4,734
Unrecognized tax benefit	3,299	3,147
Customer credit balances	4,305	3,515
Accrued vacation costs	2,256	2,446
Accrued health care costs	2,564	2,356
Other liabilities	7,130	7,911
Total accrued expenses and other liabilities	52,841	65,084
Less: Long-term portion	8,102	7,623
Accrued expenses and other current liabilities	$44,739	$ 57,461

Deferred revenue

(dollars in thousands)	June 30, 2016	December 31, 2015
Subscriptions	$139,177	$ 122,524
Maintenance	86,084	85,901
Services	29,725	28,517
License fees and other	1,675	393
Total deferred revenue	256,661	237,335
Less: Long-term portion	6,212	7,119
Deferred revenue, current portion	$250,449	$ 230,216

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Other expense, net

(dollars in thousands)	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Interest income	$118	$7	$239	$15
Loss on sale of business	—	(1,976)	—	(1,976)
Other (expense) income, net	(183)	695	(409)	400
Other expense, net	$(65)	$(1,274)	$(170)	$(1,561)

8. Debt

The following table summarizes our debt balances and the related weighted average effective interest rates, which includes the effect of interest rate swap agreements.

	Debt balance at		Weighted average effective interest rate at	
(dollars in thousands)	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
Credit facility:				
Revolving credit loans	$239,900	$ 242,900	2.19 %	2.15 %
Term loans	165,156	167,344	2.53 %	2.51 %
Total debt	405,056	410,244	2.33 %	2.30 %
Less: Unamortized debt discount	1,816	2,157		