

Synacor, 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 001-33843

Synacor, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation)

16-1542712
(I.R.S. Employer Identification No.)

40 La Riviere Drive, Suite 300 14202

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Buffalo, New York
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (716) 853-1362

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

| | |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | 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 November 2, 2018, there were 39,000,303 shares of the registrant's common stock outstanding.

SYNACOR, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SYNACOR, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED

AS OF SEPTEMBER 30, 2018 AND DECEMBER 31, 2017

(In thousands except for share and per share data)

| | September 30, 2018 | December 31, 2017 |
|---|--------------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 15,685 | \$ 22,476 |
| Accounts receivable, net of allowance of \$217 and \$99, respectively | 21,180 | 31,696 |
| Prepaid expenses and other current assets | 5,131 | 4,516 |
| Total current assets | 41,996 | 58,688 |
| PROPERTY AND EQUIPMENT, net | 19,748 | 20,505 |
| GOODWILL | 15,950 | 15,955 |
| INTANGIBLE ASSETS, net | 11,088 | 12,695 |
| OTHER ASSETS | 598 | 937 |
| Total assets | \$ 89,380 | \$ 108,780 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 17,220 | \$ 25,931 |
| Accrued expenses and other current liabilities | 6,589 | 7,075 |
| Current portion of deferred revenue | 7,481 | 11,605 |
| Current portion of capital lease obligations | 2,376 | 2,444 |
| Total current liabilities | 33,666 | 47,055 |
| LONG-TERM PORTION OF CAPITAL LEASE OBLIGATIONS | 1,668 | 3,371 |
| DEFERRED REVENUE | 2,594 | 3,682 |
| DEFERRED INCOME TAXES | 85 | 264 |
| OTHER LONG-TERM LIABILITIES | 151 | 63 |
| Total liabilities | 38,164 | 54,435 |
| COMMITMENTS AND CONTINGENCIES (Note 8) | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock – par value \$0.01 per share; authorized 10,000,000 shares; none issued | — | — |
| Common stock – par value \$0.01 per share; authorized 100,000,000 shares; | 393 | 396 |

39,826,640 shares issued and 38,977,760 shares outstanding at

September 30, 2018 and 39,625,980 shares issued and 38,783,760 shares

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| | | |
|--|-----------|------------|
| outstanding at December 31, 2017 | | |
| Treasury stock – at cost, 848,880 shares at September 30, 2018 and 842,220 | | |
| shares at December 31, 2017 | (1,893) | (1,881) |
| Additional paid-in capital | 144,334 | 142,486 |
| Accumulated deficit | (91,348) | (86,627) |
| Accumulated other comprehensive loss | (270) | (29) |
| Total stockholders' equity | 51,216 | 54,345 |
| Total liabilities and stockholders' equity | \$ 89,380 | \$ 108,780 |

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

SYNACOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

(In thousands except for share and per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| REVENUE | \$35,643 | \$36,269 | \$104,481 | \$94,025 |
| COSTS AND OPERATING EXPENSES: | | | | |
| Cost of revenue (exclusive of depreciation and amortization shown separately below) | 18,186 | 17,620 | 51,659 | 44,644 |
| Technology and development (exclusive of depreciation and amortization shown separately below) | 6,017 | 6,748 | 18,773 | 20,950 |
| Sales and marketing | 5,667 | 6,179 | 18,507 | 19,025 |
| General and administrative (exclusive of depreciation and amortization shown separately below) | 5,279 | 4,495 | 14,616 | 12,820 |
| Depreciation and amortization | 2,437 | 2,596 | 7,316 | 7,004 |
| Total costs and operating expenses | 37,586 | 37,638 | 110,871 | 104,443 |
| LOSS FROM OPERATIONS | (1,943) | (1,369) | (6,390) | (10,418) |
| GAIN ON SALE OF INVESTMENT | — | 1,902 | — | 1,902 |
| OTHER (EXPENSE) INCOME | (32) | 99 | (46) | 172 |
| INTEREST EXPENSE | (80) | (127) | (265) | (328) |
| (LOSS) INCOME BEFORE INCOME TAXES | (2,055) | 505 | (6,701) | (8,672) |
| INCOME TAX PROVISION | 165 | 244 | 478 | 999 |
| NET (LOSS) INCOME | \$(2,220) | \$261 | \$(7,179) | \$(9,671) |
| NET (LOSS) INCOME PER SHARE: | | | | |
| Basic | \$(0.06) | \$0.01 | \$(0.18) | \$(0.27) |
| Diluted | \$(0.06) | \$0.01 | \$(0.18) | \$(0.27) |
| WEIGHTED AVERAGE SHARES USED TO COMPUTE NET (LOSS) INCOME PER SHARE: | | | | |
| Basic | 38,951,558 | 38,471,377 | 38,856,836 | 35,590,563 |
| Diluted | 38,951,558 | 39,940,790 | 38,856,836 | 35,590,563 |

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

SYNACOR, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS)
 INCOME – UNAUDITED
 FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017
 (In thousands)

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|--|--|-------|---|-----------|
| Net (loss) income | \$(2,220) | \$261 | \$(7,179) | \$(9,671) |
| Other comprehensive (loss) income: | | | | |
| Changes in foreign currency translation adjustment | (66) | (23) | (241) | 21 |
| Comprehensive (loss) income | \$(2,286) | \$238 | \$(7,420) | \$(9,650) |

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

SYNACOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

(In thousands)

| | Nine Months Ended September 30, 2018 2017 | |
|---|---|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$(7,179) | \$(9,671) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 7,316 | 7,004 |
| Capitalized software impairment | — | 256 |
| Stock-based compensation expense | 1,451 | 1,928 |
| Gain on sale of long-term investment | — | (1,902) |
| Provision for deferred income taxes | (179) | 197 |
| Change in allowance for doubtful accounts | 118 | — |
| Increase in estimated value of contingent consideration | — | 107 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 10,398 | 6,933 |
| Prepaid expenses and other assets | (291) | (1,646) |
| Accounts payable | (8,284) | (1,668) |
| Accrued expenses and other liabilities | (398) | (2,369) |
| Deferred revenue | (2,756) | (2,080) |
| Net cash provided by (used in) operating activities | 196 | (2,911) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from the sale of investment | — | 2,645 |
| Purchases of property and equipment | (5,271) | (5,774) |
| Net cash used in investing activities | (5,271) | (3,129) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from offering of common stock, net of underwriting costs | — | 20,258 |
| Payments of public offering issuance costs | — | (212) |
| Repayments of long-term debt | — | (5,000) |
| Repayments on capital lease obligations | (1,811) | (914) |
| Proceeds from exercise of common stock options | 341 | 1,942 |
| Treasury stock received to satisfy minimum withholding liabilities | (12) | (117) |
| Deferred acquisition payments | — | (1,300) |
| Net cash (used in) provided by financing activities | (1,482) | 14,657 |
| Effect of exchange rate changes on cash and cash equivalents | (234) | — |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (6,791) | 8,617 |
| Cash and cash equivalents, beginning of period | 22,476 | 14,315 |
| Cash and cash equivalents, end of period | \$15,685 | \$22,932 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | \$250 | \$328 |
| Cash paid for income taxes | \$293 | \$572 |
| SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING | | |

TRANSACTIONS:

| | | |
|---|-------|---------|
| Non-cash proceeds from sale investment | \$— | \$257 |
| Property, equipment and service center contracts financed under capital lease | \$— | \$5,832 |
| Minimum capital lease payments in accounts payable | \$— | \$454 |
| Accrued property and equipment expenditures | \$142 | \$462 |
| Stock-based compensation capitalized to property and equipment | \$53 | \$116 |

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

SYNACOR, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

AS OF SEPTEMBER 30, 2018 AND DECEMBER 31, 2017, AND

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

1. The Company and Summary of Significant Accounting Principles

Synacor, Inc., together with its consolidated subsidiaries (collectively, the “Company” or “Synacor”), is the trusted technology development, multiplatform services and revenue partner for video, internet and communications providers, device manufacturers, governments and enterprises. Synacor enables its customers to provide their consumers engaging, multiscreen experiences and advertising to their consumers that require scale, actionable data and sophisticated implementation.

Basis of Presentation —

The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) and include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company’s management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company’s financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period.

The accompanying condensed consolidated balance sheet as of December 31, 2017 was derived from the audited financial statements as of that date, but does not include all the information and footnotes required by U.S. GAAP. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Accounting Estimates —

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

Concentrations of Risk —

As of September 30, 2018 and December 31, 2017, the Company had concentrations equal to or exceeding 10% of the Company’s accounts receivable as follows:

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| | Accounts Receivable | | September | |
|------------------------------|---------------------|--------------|-----------|---|
| | 30, | December 31, | | |
| | 2018 | 2017 | | |
| Google advertising affiliate | * | 16 | % | |
| Google search | 7 | 7 | % | % |
| Advertising customer | 10 | 12 | % | % |

* - Less than 10%

For the three months and nine months ended September 30, 2018 and 2017, the Company had concentrations equal to or exceeding 10% of the Company's revenue as follows:

| | Revenue | | | |
|------------------------------|-----------|------|-----------|------|
| | Three | | Nine | |
| | Months | | Months | |
| | Ended | | Ended | |
| | September | | September | |
| | 30, | 30, | | |
| | 2018 | 2017 | 2018 | 2017 |
| Google search | 14% | 17% | 14% | 15% |
| Google advertising affiliate | 10% | 22% | 12% | 19% |

For the three months and nine months ended September 30, 2018 and 2017, the following customers received revenue-share payments equal to or exceeding 10% of the Company's cost of revenue:

| | Cost of Revenue | | | |
|-------------------|---------------------------------------|------|--------------------------------------|------|
| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
| Customer A | * | 11 % | * | 13 % |
| Customer B | 21 % | 27 % | 25 % | 16 % |
| * - Less than 10% | | | | |

Recent Accounting Pronouncements —

Not Yet Adopted

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842) which amends lease accounting by lessors and lessees. This new standard will require, among other things, that lessees recognize a right-to-use asset and related lease liability for all significant financing and operating leases, and specifies where in the statement of cash flows the related lease payments are to be presented. In July 2018, the FASB issued Accounting Standards Update 2018-10, Codification Improvements to Topic 842 (Leases), and Accounting Standards Update 2018-11, Leases (Topic 842), Targeted Improvements, which provide (i) narrow amendments to clarify how to apply certain aspects of the new lease standard, (ii) entities with an additional transition method to adopt the new standard, and (iii) lessors with a practical expedient for separating components of a contract. All Accounting Standards Updates related to Topic 842 will be effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted upon issuance. The Company is currently in the process of evaluating the impact the adoption of ASU 2016-02 will have on its consolidated financial statements, but currently expects that all of its capital and operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon the adoption of ASU 2016-02, which will increase the total assets and total liabilities that it reports as compared to those reported prior to adoption. The Company will adopt the standard on the required effective date, which for the Company will be January 1, 2019.

Recently Adopted

On January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers ("Topic 606"), using the modified retrospective method. Results for reporting periods beginning on or after January 1, 2018 are presented under Topic 606; however, prior period amounts are not adjusted and continue to be reported in accordance with the accounting standards in effect for those periods. The Company recorded a reduction to the opening balance of the accumulated deficit of \$2.5 million as of January 1, 2018 due to the cumulative impact of the adoption of Topic 606. The impact to revenue recorded for the quarter ended September 30, 2018 was nominal with the adoption of Topic 606 as compared to Topic 605. The impact to revenue for the nine months ended September 30, 2018 was an increase of approximately \$0.2 million with the adoption of Topic 606 as compared to Topic 605.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. This ASU reduces the diversity in reporting of eight specific cash flow issues due to accounting guidance that is unclear or does not exist. The eight issues relate to certain debt activities, business combination activities, insurance settlements and other various activities. The Company adopted this ASU as of January 1, 2018 and it did not have an impact on its consolidated financial statements.

2. Revenue from Contracts with Customers

The following is a description of principal activities from which the Company generates revenue. Revenue is recognized when control of the promised goods or services are transferred to the Company's customers, in an amount that reflects the consideration that is expected to be received in exchange for those goods or services. The Company generates all of its revenue from contracts with customers.

Search & Digital Advertising

The Company uses internet advertising to generate revenue from the traffic on its Managed Portals and Advertising solutions, categorized as search advertising and digital advertising. For search advertising, the Company has a revenue-sharing relationship with Google, pursuant to which the Company includes a Google-branded search tool on its Managed Portals. When a Google consumer makes a search query using this tool, the Company delivers the query to Google and they return search results to consumers that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with the Company. The net payment received from Google is recognized as revenue. Digital advertising includes video, image and text advertisements delivered on its Managed Portals. Advertising inventory is filled with advertisements sourced by the Company's direct sales force and advertising network partners. Revenue is generated when an advertisement displays, otherwise known as an impression, or when consumers view or click an advertisement, otherwise known as an action. Digital advertising revenue is on a cost per impression or cost per action basis. Digital advertising also includes advertising fees received for the placement of syndicated digital advertisements with other digital advertising publishers, for which the Company acquires and pay for the space (inventory) on a cost per impression or cost per action basis. Revenue is recognized based on amounts received from advertising customers as the impressions are delivered or the actions occur, according to contractually-determined rates.

Recurring and Fee-Based

Recurring and Fee-Based revenue includes subscription fees and other fees that are received from customers for the use of the Company's proprietary technology, including the use of, or access to, email, Cloud ID, security services, games and other premium services and paid content. Monthly subscriber levels typically form the basis for generating Recurring and Fee-Based revenue. This revenue is typically determined by multiplying a per-subscriber per-month fee by the number of subscribers using the particular services being offered or consumed, except in the case of software licenses and support, which are based on a fixed fee. Revenue earned as subscription fees and maintenance and support fees is recognized from customers as its obligation to deliver the service is satisfied, which is when the service is delivered. Revenue is also recognized from the licensing and distribution of the Company's Email/Collaboration products and services, including licenses of intellectual property. Software license revenue is recognized up front upon delivery of the licensed product and the utility that enables the customer to access authorization keys, provided that a signed contract has been received. The Company typically sells term-based software licenses that expire, which are referred to as subscription licenses, but also sell perpetual licenses for its Email products. The software is delivered before related services are provided and is functional without professional services, updates, and technical support.

Many of the Company's contracts with customers contain multiple performance obligations. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of software licenses are typically estimated using the residual approach. Standalone selling prices of services are typically estimated based on observable transactions when these services are sold on a standalone basis. The Company usually expects payment within 30 to 90 days from the invoice date (fulfillment of performance obligations or per contract terms). None of the Company's contracts as of September 30, 2018 contained a significant financing

component. Differences between the amount of revenue recognized and the amount invoiced, collected from, or paid to its customers are recognized as deferred revenue.

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Disaggregation of revenue

The following table provides information about disaggregated revenue for the three and nine months ended September 30, 2018 by primary geographical market and timing of revenue recognition, and includes a reconciliation of the disaggregated revenue with reportable types (in thousands):

| Three Months Ended September 30, 2018 | | | | | |
|---------------------------------------|---------------------------------|---------------|--|---|-----------|
| Geographic Area | | | Timing of Revenue Recognition Products transferred | | |
| | United States (in thousands) | International | at a point in time (in thousands) | Products and services transferred over time | Total |
| Revenue: | | | | | |
| Search and Digital advertising | \$ 20,592 | \$ 618 | \$21,210 | \$ — | \$21,210 |
| Recurring and Fee-based | 8,601 | 5,832 | 3,866 | 10,567 | \$14,433 |
| Total revenue | \$ 29,193 | \$ 6,450 | \$25,076 | \$ 10,567 | \$35,643 |
| Nine Months Ended September 30, 2018 | | | | | |
| Geographic Area | | | Timing of Revenue Recognition Products transferred | | |
| | United States (in thousands) | International | at a point in time (in thousands) | Products and services transferred over time | Total |
| Revenue: | | | | | |
| Search and Digital advertising | \$ 59,720 | \$ 2,295 | \$62,015 | \$ — | \$62,015 |
| Recurring and Fee-based | 25,865 | 16,601 | 10,016 | 32,450 | \$42,466 |
| Total revenue | \$ 85,585 | \$ 18,896 | \$72,031 | \$ 32,450 | \$104,481 |

Remaining Performance Obligations

Deferred revenue is recorded when cash payments are received or due in advance of revenue recognition from software licenses, professional services, and maintenance agreements. The timing of revenue recognition may differ from the timing of billings to customers. The changes in deferred revenue, inclusive of both current and long-term, are

as follows:

| | |
|--|----------|
| (in thousands) | |
| Beginning balance - January 1, 2018 | \$15,287 |
| Record the cumulative effect of ASC 606 implementation | (2,456) |
| Recognition of deferred revenue | (10,500) |
| Deferral of revenue | 7,744 |
| Ending Balance - September 30, 2018 | \$10,075 |

The majority of the deferred revenue balance above relates to the maintenance and support contracts for Email software licenses. These are recognized straight-line over the life of the contract, with the majority of the balance being recognized within the next twelve months.

Practical Expedients

The Company generally expenses sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within sales and marketing expenses.

The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which revenue is recognized at the amount to which the Company has the right to invoice for services performed.

3. Acquisitions

In August 2015, the Company and Zimbra, Inc. (now known as “TZ Holdings”) entered into an agreement under which the Company acquired certain assets relating to TZ Holdings’ email/collaboration products and services business, including certain of its wholly-owned foreign subsidiaries, for cash consideration of \$17.3 million, 2.4 million shares of common stock and warrants to purchase 480,000 shares of common stock (collectively valued at \$3.2 million). The Company held back an additional 600,000 shares of common stock and warrants to purchase an additional 120,000 shares of common stock (collectively valued at \$0.8 million at the acquisition date) to secure TZ Holdings’ indemnification obligations including pending claims. The held back common shares and warrants were released to TZ holdings in March 2017. The warrants expired unexercised on September 14, 2018.

Additionally, TZ Holdings was eligible to receive cash consideration of up to \$2.0 million (the “Earn-Out Consideration”) upon the satisfaction of certain business performance milestones following the closing of the transaction, subject to and contingent upon any reduction to satisfy indemnification claims including pending claims. The acquisition date fair value of this contingent consideration was estimated to be \$1.6 million. The Company paid \$0.9 million of the Earn-Out Consideration to TZ Holdings in November 2016, and the Company paid the remaining \$0.7 million of the Earn-Out Consideration in May 2017.

In connection with the Company’s February 2016 acquisition of Technorati, the Company withheld \$0.5 million of the purchase price to secure Technorati’s indemnification obligations under the Asset Purchase Agreement, and the Company owed approximately \$0.1 million in post-closing working capital adjustments. These amounts were paid in March 2017.

4. Intangible Assets

Intangible assets consisted of the following (in thousands):

| | September 30, 2018 | December 31, 2017 |
|--------------------------------------|-----------------------|----------------------|
| Customer and publisher relationships | \$ 14,780 | \$ 14,780 |
| Technology | 2,330 | 2,330 |
| Trademark | 300 | 300 |
| | 17,410 | 17,410 |
| Less accumulated amortization | (6,322) | (4,715) |
| Intangible assets, net | \$ 11,088 | \$ 12,695 |

Amortization of intangible assets totaled \$0.5 million for the three months ended both September 30, 2018 and 2017, and \$1.6 million for the nine months ended both September 30, 2018 and 2017.

5. Property and Equipment – Net

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

| | September 30, 2018 | December 31, 2017 |
|--------------------|-----------------------|----------------------|
| Computer equipment | \$ 28,997 | \$ 28,845 |
| Computer software | 27,248 | 23,690 |

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| | | |
|--|-----------|-----------|
| Furniture and fixtures | 1,624 | 1,497 |
| Leasehold improvements | 1,258 | 1,215 |
| Work in process (primarily software development costs) | 4,719 | 3,758 |
| Other | 179 | 159 |
| | 64,025 | 59,164 |
| Less accumulated depreciation | (44,277) | (38,659) |
| Property and equipment, net | \$ 19,748 | \$ 20,505 |

Depreciation expense totaled \$1.9 million and \$2.1 million for the three months ended September 30, 2018 and 2017, respectively, and \$5.7 million and \$5.4 million, for the nine months ended September 30, 2018 and 2017, respectively.

6. Accrued Expenses and Other Current Liabilities

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

| | September 30, 2018 | December 31, 2017 |
|---|-----------------------|----------------------|
| Accrued compensation | \$ 4,819 | \$ 4,361 |
| Accrued content fees and other costs of revenue | 300 | 655 |
| Accrued taxes | 228 | 426 |
| Other | 1,242 | 1,633 |
| Total | \$ 6,589 | \$ 7,075 |

Included in accrued compensation are accrued severance costs. In 2018, the Company initiated a cost reduction program to drive overall efficiency while adding capacity and streamlining the organization. These actions will result in workforce reductions, office consolidations and consolidating operations. Severance costs charged to technology and development and sales and marketing expenses were each \$0.3 million and \$0.4 million was charged to general and administrative expenses for the nine months ended September 30, 2018. The below table summarizes the activity in the accrued severance account.

| | September 30, 2018 |
|-------------------------------|-----------------------|
| Balance at January 1, 2018 | \$ 21 |
| Charged to expense | 1,034 |
| Cash payments | (569) |
| Balance at September 30, 2018 | \$ 486 |

7. Information About Segment and Geographic Areas

Operating segments are components of the Company in which separate financial information is available that is evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a total company basis, accompanied by information about revenue by major service line for purposes of allocating resources and evaluating financial performance. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results or plans for levels or components below the company level. Accordingly, the Company has determined that it has a single reporting segment and operating unit structure.

The following tables set forth revenue and long-lived tangible assets by geographic area (in thousands):

| Three Months Ended | Nine Months Ended |
|-----------------------|----------------------|
|-----------------------|----------------------|

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| | September 30, | | September 30, | |
|-----------------|---------------|----------|---------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue: | | | | |
| United States | \$29,193 | \$30,742 | \$85,585 | \$77,600 |
| International | 6,450 | 5,527 | 18,896 | 16,425 |
| Total revenue | \$35,643 | \$36,269 | \$104,481 | \$94,025 |

| | September | December 31, |
|------------------------------------|-----------|--------------|
| | 30, 2018 | 2017 |
| Long-lived tangible assets: | | |
| United States | \$ 19,175 | \$ 19,775 |
| International | 573 | 730 |
| Total long-lived tangible assets | \$ 19,748 | \$ 20,505 |

8. Commitments and Contingencies

Contract Commitments —

The Company is obligated to make minimum payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of September 30, 2018 are as follows (in thousands):

| | |
|-------------------------------|---------|
| Year ending December 31, | |
| 2018 (remaining three months) | \$ 225 |
| 2019 | 1,353 |
| 2020 | 753 |
| Total | \$2,331 |

Capital Lease Commitments —

Capital lease commitments for the remainder of 2018 and for the following two years as of September 30, 2018 are summarized as follows (in thousands):

| | Capital Lease |
|--|---------------|
| Years Ending December 31, | Commitments |
| 2018 (remaining three months) | \$ 748 |
| 2019 | 2,348 |
| 2020 | 1,152 |
| Total minimum capital lease commitments | 4,248 |
| Less-amount representing interest | (204) |
| Total capital lease obligations | 4,044 |
| Less-minimum capital lease obligations in accounts payable | - |
| Less-current portion of capital lease obligations | (2,376) |
| Long-term portion of capital lease obligations | \$ 1,668 |

Litigation —

The Company is awaiting a decision of an arbitration tribunal following a binding arbitration that took place on July 30, 2018 between the Company and Maxit Technology Incorporated and Maxit Technology Holdings Limited, or Maxit, who were formerly the Company's joint venture partners in China. After unsuccessful settlement discussions between the parties, on January 25, 2016, Maxit requested arbitration under the Rules of the International Chamber of Commerce. In its request for arbitration, Maxit asserted claims for breach of contract, breach of the covenant of good faith and fair dealing, breach of fiduciary duty, and negligent misrepresentation, all arising out of the Company's alleged failure to provide capital and software as required by the joint venture agreement. In its request, Maxit sought an award of money damages based on its share of the lost potential value of the joint venture, as well as a percentage of revenue from any future sales to customers originally introduced by Maxit, interest and legal expenses. Maxit alleges that its share of the lost potential value is approximately \$15 million. Based in part on an independent appraisal, the Company assessed the lost potential value at only \$0.6 million, for which half of this amount (based on 50/50 ownership) has been reserved in its financial statements. The Company contested Maxit's claims vigorously, and while it is not possible at this time to predict the outcome of the arbitration, the Company continues to believe that Maxit's claims are without merit. It anticipates a decision by the arbitration tribunal before the end of the calendar year 2018.

The Company and its Chief Executive Officer and former Chief Financial Officer were named as defendants in a federal securities class action lawsuit filed April 4, 2018 in the United States District Court for the Southern District of New York. The class includes persons who purchased the Company's shares between May 4, 2016 and March 15, 2018. The plaintiff alleged that the Company made materially false and misleading statements regarding its contract with AT&T and the timing of revenue to be derived therefrom, and that as a result class members suffered losses because Synacor shares traded at artificially inflated prices. The plaintiff sought an unspecified amount of damages, as well as interest, attorneys' fees and legal expenses. The court appointed a lead plaintiff and approved plaintiff's selection of lead counsel on July 6, 2018. On October 16, 2018 the court appointed new lead counsel and confirmed the lead plaintiff. The plaintiff filed an amended complaint on November 2, 2018. The Company disputes these claims and intends to defend them vigorously. The liabilities related to this lawsuit are covered by D&O insurance after the Company reaches its deductible.

In addition, the Company is, from time to time, party to litigation arising in the ordinary course of business. It does not believe that the outcome of these claims will have a material adverse effect on its consolidated financial position, results of operations or cash flows based on the status of proceedings at this time. However, regardless of the outcome, such proceedings can have an adverse impact on the Company because of defense and settlement costs, diversion of resources and other factors.

9. Stock-based Compensation

The Company has stock-based employee compensation plans for which compensation cost is recognized in its financial statements. The cost is measured at the grant date, based on the fair value of the award, determined using the Black-Scholes option pricing model, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity award).

No income tax deduction is allowed for incentive stock options ("ISOs"). Accordingly, no deferred income tax asset is recorded for the potential tax deduction related to these options. Expense related to stock option grants of non-qualified stock options ("NSOs") results in a temporary difference, which gives rise to a deferred tax asset.

The following table presents the weighted-average assumptions used to estimate the fair value of options granted during the periods indicated:

| | Nine Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|--|--|---|--|---|
| Weighted average grant date fair value | \$ 1.01 | | \$ 1.53 | |
| Expected dividend yield | — | % | — | % |
| Expected stock price volatility | 48 | % | 47 | % |
| Risk-free interest rate | 2.7 | % | 2.1 | % |
| Expected life of options (in years) | 6.25 | | 6.36 | |

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Total stock-based compensation expense included in the accompanying condensed consolidated statements of operations for the periods presented, is as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|-------|---------------------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Technology and development | \$101 | \$190 | \$369 | \$604 |
| Sales and marketing | 110 | 142 | 374 | 500 |
| General and administrative | 150 | 273 | 708 | 824 |
| Total stock-based compensation expense | \$361 | \$605 | \$1,451 | \$1,928 |

Stock Option Activity – A summary of the stock option activity for the nine months ended September 30, 2018 is presented below:

| | Number of Shares | Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (in thousands) |
|---|---------------------|-------------------|--|---|
| Outstanding at January 1, 2018 | 8,478,213 | \$ 2.60 | | |
| Granted | 1,109,400 | 2.03 | | |
| Exercised | (180,644) | 1.56 | | |
| Forfeited or expired | (1,192,599) | 2.59 | | |
| Outstanding at September 30, 2018 | 8,214,370 | \$ 2.54 | 6.45 | \$ 79 |
| Vested and expected to vest at September 30, 2018 | 7,997,637 | \$ 2.55 | 6.37 | \$ 78 |
| Vested and exercisable at September 30, 2018 | 5,731,815 | \$ 2.59 | 5.48 | \$ 57 |

Aggregate intrinsic value represents the difference between the Company's closing stock price of its common stock and the exercise price of outstanding, in-the-money options. The Company's closing stock price as reported on the Nasdaq Global Market as of September 30, 2018 was \$1.60 per share. The total intrinsic value of options exercised for the nine months ended September 30, 2018 was minimal. The weighted average fair value of options granted during the nine months ended September 30, 2018 amounted to \$1.01 per option share.

As of September 30, 2018, the unrecognized compensation cost related to options granted, for which vesting is probable, and adjusted for estimated forfeitures, was approximately \$2.8 million. This cost is expected to be recognized over a weighted-average remaining period of 2.6 years.

10. Net (Loss) Income Per Common Share Data

Basic net (loss) income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net (loss) income per share is computed using the weighted-average number of common shares and, if dilutive, potential common shares outstanding during the period. The Company's potential common shares consist of the incremental common shares issuable upon the exercise of stock options, warrants, and to a lesser extent, shares issuable upon the release of RSUs. The dilutive effect of these potential common shares is reflected in diluted earnings per share by application of the treasury stock method.

Stock options, warrants and RSUs are not included in the calculation of diluted net loss per share for the three and nine months ended September 30, 2018 and the nine months ended September 30, 2017 because the Company had a net loss for each of those periods. The inclusion of these equity awards would have had an antidilutive effect on the calculation of diluted loss per share. As such, the Company's calculations of basic and diluted net loss per share are identical.

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The following table presents the calculation of basic and diluted net (loss) income per share for the three months and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| Basic net (loss) income per share: | | | | |
| Numerator: | | | | |
| Net (loss) income (in thousands) | \$(2,220 |) \$261 | \$(7,179 |) \$(9,671 |
| Denominator: | | | | |
| Weighted average common shares outstanding | 38,951,558 | 38,471,377 | 38,856,836 | 35,590,563 |
| Basic net (loss) income per share | \$(0.06 |) \$0.01 | \$(0.18 |) \$(0.27 |
| Diluted net (loss) income per share: | | | | |
| Numerator: | | | | |
| Net (loss) income (in thousands) | \$(2,220 |) \$261 | \$(7,179 |) \$(9,671 |
| Denominator: | | | | |
| Weighted average common shares outstanding - basic | 38,951,558 | 38,471,377 | 38,856,836 | 35,590,563 |
| Add - potentially dilutive securities (options, RSUs and warrants) | — | 1,469,413 | — | — |
| Weighted average common shares outstanding - diluted | 38,951,558 | 39,940,790 | 38,856,836 | 35,590,563 |
| Diluted net (loss) income per share | \$(0.06 |) \$0.01 | \$(0.18 |) \$(0.27 |

The following securities were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive for the periods presented:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| Anti-dilutive equity awards: | | | | |
| Stock options | 8,214,370 | 2,330,897 | 8,214,370 | 8,706,131 |
| Restricted stock units | 21,846 | 62,221 | 21,846 | 127,226 |
| Warrants | 495,652 | — | 564,835 | 600,000 |

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

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as "may," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and other expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. These forward-looking statements include statements in this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations." Factors that could cause or contribute to such differences include, but are not limited to, those in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-Q and with the consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Our Business

We enable our customers to better engage with their consumers. Our customers include video, internet and communications providers, device manufacturers, governments and enterprises. We are their trusted technology development, multiplatform services and revenue partner. Our customers use our technology platforms and services to scale their businesses and extend their subscriber relationships. We deliver managed portals, advertising solutions, email and collaboration platforms, and cloud-based identity management.

We enable our customers to provide their consumers engaging, multiscreen experiences with products that require scale, actionable data and sophisticated implementation. Through our Managed Portals and Advertising solutions, we enable our customers to earn incremental revenue by monetizing media among their consumers. At the same time, because consumers have high expectations for their online experience as a result of advances in video, mobile and social, we provide, through our Recurring and Fee-Based revenue solutions, a suite of products and services that helps our customers successfully meet those high expectations by enabling them to deliver to their consumers access to the same digital content across all devices, including PCs, tablets, smartphones and connected TVs.

Overview

We generate search and digital advertising revenue from consumer traffic on our Managed Portals and Advertising solutions, which we collect from our search partner, Google Inc., or Google, our advertising network providers and directly from advertisers. We typically share a portion of this Managed Portals and Advertising revenue with our customers. Growth in this portion of our business is dependent on expansion of relationships with our existing customers and new customers adopting our Managed Portals and Advertising solutions and increased engagement by their consumers with these solutions.

We also generate revenue from our Recurring and Fee-Based revenue solutions for the use of our technology, email and messaging, premium services and paid content. We generate this revenue in the form of licensing fees including perpetual licenses, subscription licenses, maintenance and support fees and professional services. As we expand our Cloud ID, syndicated content, Email/Collaboration and other premium services offerings, we expect to generate increased Recurring and Fee-Based revenue from our customers.

As we obtain new customers and those new customers introduce our Managed Portals and Advertising solutions to their consumers, and as new customers migrate their consumers from their existing technology to our technology over a period of time, we expect usage of our solutions and revenue from those Managed Portals and Advertising solutions to increase. Moreover, a new customer may initially launch a selection of our services and products, rather than our entire suite of offerings and subsequently broaden their service and product offerings over time. When a customer launches a new service or product, marketing and promotional activities may be required to generate awareness and interest among consumers.

Revenue attributable to our customers includes the Recurring and Fee-Based revenue earned directly from them, as well as the Managed Portals and Advertising revenue generated through our relationships with our search and digital advertising partners (such as Google for search advertising and advertising networks, advertising agencies and advertisers for digital advertising). This revenue is attributable to our customers because it is produced from the traffic on our Managed Portals. These search and advertising partners provide us with advertisements that we then deliver with search results and other content on our Managed Portals. Since our search advertising partner, Google, and our advertising network partners generate their revenue by selling those advertisements, we create a revenue stream for these partners. In the three and nine months ended September 30, 2018, search revenue through our relationship with Google generated \$4.8 million and \$14.7 million, or approximately 14% of our revenue for both periods. For the three and nine months ended September 30, 2018, Managed Portals and Advertising solutions and other services attributable to one customer accounted for \$10.8 million and \$29.8 million, or approximately 30% and 29% of our revenue, respectively.

The initiatives described below under “Key Initiatives” are expected to contribute to our ability to maintain and grow revenue and return to operating profitability via increases in advertising revenue, increases in customers and our consumer reach, and increases in availability of products across more devices. We expect the period in which we experience a return on future investments in each of these initiatives to differ. For example, more direct advertising at higher rates would be expected to have an immediate and direct impact on profitability while expansion into international markets may require an investment that involves a longer term return.

Key Initiatives

Our strategy is supported by four key pillars to drive our business, with operational discipline and sound financial footing as its base. We plan to:

- increase value for existing customers by optimizing consumer experience and monetization;
- innovate on Synacor-as-a-platform for advanced services;
- win new customers in current and related verticals; and
- extend our product portfolio into emerging growth areas.

Key Business Metrics

In addition to the line items in our financial statements, we also review various metrics to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe disclosing these metrics is useful for investors and analysts by providing increased transparency and a better understanding of the underlying trends in our business.

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|--|--|-------|---|--------|
| Multiplatform Unique Visitors (millions) | 200.4 | 197.2 | 201.3 | 198.8 |
| Recurring Software Revenue (millions) | \$8.9 | \$7.6 | \$26.7 | \$23.8 |

Multiplatform Unique Visitors represents the number of consumers who have visited one of our Managed Portals from either mobile or desktop sources or viewed an advertisement through our advertising network, at least once, computed on an average monthly basis during a particular time period.

Recurring Software Revenue consists of fees recognized over time for the use of or access to software and services such as e-mail and messaging, security, Cloud ID, and other paid content. As Recurring Software Revenue increases, this results in an increasing base of predictable revenue.

Components of our Results of Operations

Cost of Revenue

Cost of revenue consists primarily of revenue sharing, content acquisition costs, co-location facility costs, royalty costs, and product support costs. Revenue sharing consists of amounts accrued and paid to customers for the internet traffic on Managed Portals we operate on our customers' behalf and where we are the primary obligor, resulting in the generation of search and digital advertising revenue. The revenue-sharing agreements with customers are primarily variable payments based on a percentage of the search and digital advertising revenue. Content-acquisition agreements may be based on a fixed payment schedule, on the number of subscribers per month, or a combination of both. Fixed-payment agreements are expensed on a straight-line basis over the term defined in the agreement. Agreements based on the number of subscribers are expensed on a monthly basis. Co-location facility costs consist of rent and operating costs for our data center facilities. Royalty costs consist of amounts due to other parties for license of email software with third party technology enabled. Product support costs consist of employee and operating costs directly related to our maintenance and professional services support.

Technology and Development

Technology and development expenses consist primarily of compensation-related expenses incurred for the research and development of, enhancements to, and maintenance and operation of our products, equipment and related infrastructure. Technology and development expenses also include certain costs of operating data centers domestically and internationally.

Sales and Marketing

Sales and marketing expenses consist primarily of compensation-related expenses to our direct sales and marketing personnel, as well as costs related to advertising, industry conferences, promotional materials and other sales and marketing programs. Advertising cost is expensed as incurred.

General and Administrative

General and administrative expenses consist primarily of compensation-related expenses for executive management, finance, accounting, human resources, professional fees and other administrative functions.

Depreciation and Amortization

Depreciation and amortization includes depreciation and amortization of our computer hardware and software, including our capitalized internally-developed software, furniture and fixtures, intangible assets, leasehold improvements and other property, as well as depreciation on capital leased assets.

Other (Expense) Income

Other income consists primarily of foreign currency transaction gains and losses, and interest income earned.

Interest Expense

Interest expense consists of interest on capital leases and outstanding bank borrowings, if any.

Provision for Income Taxes

Income tax provision consists of federal and state income taxes in the United States and taxes in certain foreign jurisdictions, as well as any changes to deferred tax assets or liabilities, and deferred tax valuation allowances. Our income tax provision also includes amounts withheld for payment of income taxes upon payment of our invoices by our customers in certain foreign jurisdictions. Those amounts increase the amount of our foreign tax credit which would defray our U.S. tax liability if we were presently a U.S. taxpayer. However, because the deferred income tax assets relating to our federal tax attributes, including our foreign tax credits, are fully reserved, any such foreign tax withholdings are charged to our income tax provision. Such amounts paid may be carried forward to offset future federal income tax liabilities for a period of ten years. Finally, we record a deferred income tax provision to reflect the recognition of deferred tax liabilities relating to goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carry-forward periods.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these

condensed consolidated financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Our estimates form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimate that are reasonably likely to occur, could materially impact the condensed consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

For a discussion of our critical accounting policies and estimates, see “Critical Accounting Policies and Estimates” included in our Annual Report on Form 10-K for the year ended December 31, 2017 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We have updated our revenue recognition policies in conjunction with the adoption of ASC 606 as further described in Note 2 to the accompanying condensed consolidated financial statements. No other significant changes have occurred to our critical accounting policies and estimates.

Adjusted EBITDA

To provide investors with additional information regarding our financial results, we have disclosed within this Quarterly Report on Form 10-Q adjusted EBITDA, a non-U.S. GAAP financial measure. We define adjusted EBITDA as net income (loss) plus: provision (benefit) for income taxes, interest expense, other (income) expense, depreciation and amortization, asset impairments, stock-based compensation, restructuring costs, acquisition costs and certain other one-time items. We have provided a reconciliation below of adjusted EBITDA to net income (loss), the most directly comparable U.S. GAAP financial measure.

We have included adjusted EBITDA in this Quarterly Report on Form 10-Q because it is a key measure used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget and to develop short- and long-term operational plans. In particular, the exclusion of certain expenses in calculating adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Additionally, adjusted EBITDA is a key financial measure used by the compensation committee of our board of directors in connection with the payment of bonuses to our executive officers. Accordingly, we believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

Our use of adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- although depreciation and amortization and asset impairments are non-cash charges, the assets being depreciated, amortized or impaired may have to be replaced in the future, and adjusted EBITDA does not reflect capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not consider the potentially dilutive impact of equity-based compensation;
- adjusted EBITDA does not reflect the impact of tax payments that may represent a reduction in cash available to us;
- adjusted EBITDA does not reflect the impact of principal or interest payments required to service our capital leases or long-term debt borrowings (if any);
- adjusted EBITDA does not reflect the impact of the cost of business acquisitions on the cash available to us;
- adjusted EBITDA does not reflect the impact of non-recurring items, such as the costs associated with reductions in workforce, on the cash available to us; and
- other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

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

| | Three Months Ended September 30, 2018 2017 (in thousands) | | Nine Months Ended September 30, 2018 2017 (in thousands) | |
|---|---|----------|--|------------|
| Reconciliation of Adjusted EBITDA: | | | | |
| Net (loss) income | \$ (2,220) | \$ 261 | \$ (7,179) | \$ (9,671) |
| Income tax provision | 165 | 244 | 478 | 999 |
| Interest expense | 80 | 127 | 265 | 328 |
| Other expense (income) | 32 | (99) | 14 | (172) |
| Gain on sale of investment | — | (1,902) | 0 | (1,902) |
| Depreciation and amortization | 2,437 | 2,596 | 7,316 | 7,004 |
| Capitalized software impairment | — | — | — | 256 |
| Stock-based compensation expense | 361 | 605 | 1,451 | 1,928 |
| Restructuring costs | 766 | — | 1,034 | — |
| Certain legal expenses * | 1,033 | — | 1,033 | — |
| Adjusted EBITDA | \$ 2,654 | \$ 1,832 | \$ 4,412 | \$ (1,230) |

*"Certain legal expenses" include legal fees and other related expenses associated with legal proceedings outside the ordinary course of our business, including the class action securities litigation, and arbitration costs related to the dissolution of a former joint venture.

Results of Operations

The following tables set forth our results of operations for the periods presented in amount and as a percentage of revenue for those periods. The period to period comparison of financial results is not necessarily indicative of future results.

| | Three Months | | Nine Months Ended | |
|---|----------------|---------------|-------------------|---------------|
| | Ended | | September 30, | |
| | September 30, | September 30, | September 30, | September 30, |
| | 2018 | 2017 | 2018 | 2017 |
| | (in thousands) | | (in thousands) | |
| Revenue | \$35,643 | \$36,269 | \$104,481 | \$94,025 |
| Costs and operating expenses: | | | | |
| Cost of revenue ¹ | 18,186 | 17,620 | 51,659 | 44,644 |
| Technology and development ^{1 2} | 6,017 | 6,748 | 18,773 | 20,950 |
| Sales and marketing ² | 5,667 | 6,179 | 18,507 | 19,025 |
| General and administrative ^{1 2} | 5,279 | 4,495 | 14,616 | 12,820 |
| Depreciation and amortization | 2,437 | 2,596 | 7,316 | 7,004 |
| Total costs and operating expenses | 37,586 | 37,638 | 110,871 | 104,443 |
| Loss from operations | (1,943) | (1,369) | (6,390) | (10,418) |
| Gain on sale of investment | — | 1,902 | — | 1,902 |
| Other (expense) income | (32) | 99 | (46) | 172 |
| Interest expense | (80) | (127) | (265) | (328) |
| Loss (income) before income taxes | (2,055) | 505 | (6,701) | (8,672) |
| Income tax provision | 165 | 244 | 478 | 999 |
| Net (loss) income | \$(2,220) | \$261 | \$(7,179) | \$(9,671) |

Notes:

¹Exclusive of depreciation and amortization shown separately

² Includes stock-based compensation, as follows:

| | Three | | Nine Months | |
|----------------------------|------------|-----------|---------------|---------------|
| | Months | | Ended | |
| | Ended | | September 30, | |
| | September | September | September 30, | September 30, |
| | 30, | 30, | 2018 | 2017 |
| | 2018 | 2017 | 2018 | 2017 |
| | (in | | (in | |
| | thousands) | | thousands) | |
| Technology and development | \$101 | \$190 | \$369 | \$604 |
| Sales and marketing | 110 | 142 | 374 | 500 |
| General and administrative | 150 | 273 | 708 | 824 |
| | \$361 | \$605 | \$1,451 | \$1,928 |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|------|---------------------------------|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue | 100% | 100% | 100% | 100% |
| Costs and operating expenses: | | | | |
| Cost of revenue ¹ | 51 | 49 | 49 | 47 |
| Technology and development ¹ | 17 | 19 | 18 | 22 |
| Sales and marketing | 16 | 17 | 18 | 20 |
| General and administrative ¹ | 15 | 12 | 14 | 14 |
| Depreciation and amortization | 7 | 7 | 7 | 7 |
| Total costs and operating expenses | 106 | 104 | 106 | 110 |
| Loss from operations | (6) | (4) | (6) | (10) |
| Gain on sale of investment | — | 5 | — | 2 |
| Other (expense) income | — | — | — | — |
| Interest income | — | — | — | — |
| Loss (income) before income taxes | (6) | 1 | (6) | (8) |
| Income tax provision | — | — | — | 1 |
| Net (loss) income | (6)% | 1 % | (6)% | (9)% |

Note:

¹Exclusive of depreciation and amortization shown separately
Comparison of the three and nine months ended September 30, 2018 and 2017:

Revenue

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|--------------------------------|----------------------------------|----------|----------|---------------------------------|----------|----------|
| | 2018 | 2017 | % Change | 2018 | 2017 | % Change |
| (in thousands) | | | | | | |
| Revenue: | | | | | | |
| Search and digital advertising | \$21,210 | \$22,674 | (6) | \$62,015 | \$54,188 | 14 |
| Recurring and fee-based | 14,433 | 13,595 | 6 | 42,466 | 39,837 | 7 |
| Total revenue | \$35,643 | \$36,269 | (2) | \$104,481 | \$94,025 | 11 |
| Percentage of Revenue: | | | | | | |
| Search and digital advertising | 60 % | 63 % | | 59 % | 58 % | |
| Recurring and fee-based | 40 % | 37 % | | 41 % | 42 % | |
| Total revenue | 100 % | 100 % | | 100 % | 100 % | |

Three months - 2018 compared to 2017. Revenue in the three months ended September 30, 2018 decreased by \$0.6 million, or 2%, compared to the same period in 2017. Search and digital advertising revenue decreased by \$1.5 million, or 6% which was primarily due lower syndicated advertising revenue as we increased focus on margins, which was only partially offset by slightly higher AT&T revenue.

Recurring and Fee-Based revenue in 2018 increased by \$0.8 million, or 6%, compared to the same period in 2017. This was primarily due to higher hosted email and professional services revenue which offset a decline in portal value added services fees.

Nine months - 2018 compared to 2017. Revenue in the nine months ended September 30, 2018 increased by \$10.5 million, or 11%, compared to the same period in 2017. Search and digital advertising revenue increased by \$7.8 million, or 14%. This was primarily due to increased search revenue and digital advertising revenue attributable to AT&T, which more than offset declines in portal and syndicated advertising.

Recurring and Fee-Based revenue in the nine months ended September 30, 2018 increased by \$2.6 million, or 7%, compared to the same period in 2017 primarily due to higher hosted email services revenue, portal licensing revenue and professional services revenue, which was partially offset by decreased portal value added services fees, service provider subscriptions and video services fees.

Cost of Revenue

| | Three Months Ended September 30, 2018 | | | 2017 | | | % Change | | |
|-----------------------|---------------------------------------|----------|----------|----------|----------|----------|----------|------|----------|
| | 2018 | 2017 | % Change | 2018 | 2017 | % Change | 2018 | 2017 | % Change |
| Cost of revenue | \$18,186 | \$17,620 | 3 | \$51,659 | \$44,644 | 16 | | | |
| Percentage of revenue | 51 | % 49 | % | 49 | % 47 | % | | | |

Three months - 2018 compared to 2017. Cost of revenue increased by \$0.6 million, or 3%, for the three months ended September 30, 2018 as compared to the same period in the prior year. The increase in cost was due primarily to the increased revenue sharing costs, lower margins on syndicated advertising and higher IT infrastructure costs.

Nine months - 2018 compared to 2017. Cost of revenue increased by \$7.0 million, or 16% for the nine months ended September 30, 2018 as compared to the same period in the prior year. The increase in cost was due primarily to the increase in revenue sharing costs, lower margins on syndicated advertising and higher IT infrastructure costs.

Technology and Development Expenses

| | Three Months Ended September 30, 2018 | | | 2017 | | | % Change | | |
|-------------------------------------|---------------------------------------|---------|----------|----------|----------|----------|----------|------|----------|
| | 2018 | 2017 | % Change | 2018 | 2017 | % Change | 2018 | 2017 | % Change |
| Technology and development expenses | \$6,017 | \$6,748 | (11) | \$18,773 | \$20,950 | (10) | | | |
| Percentage of revenue | 17 | % 22 | % | 18 | % 22 | % | | | |

Three months - 2018 compared to 2017. Technology and development expenses decreased by \$0.7 million, or 11%, in the three months ended September 30, 2018 as compared to 2017, as a result of lower compensation and consulting expenses in the quarter.

Nine months - 2018 compared to 2017. The decrease in the nine months ended September 30, 2018 as compared to the same period in 2017 was \$2.2 million, or 10%, and was primarily due to lower compensation and consulting expenses and incremental costs incurred last year related to product development and support for the AT&T portal services business, along with a \$0.3 million impairment charge recorded in 2017 to write down the value of a software development project to its estimated net realizable value.

Sales and Marketing Expenses

| | Three Months Ended | | | Nine Months Ended | | |
|-----------------------|--------------------|---------|----------|--------------------|----------|----------|
| | September 30, 2018 | 2017 | % Change | September 30, 2018 | 2017 | % Change |
| | (in thousands) | | | (in thousands) | | |
| Sales and marketing | \$5,667 | \$6,179 | (8) | \$18,507 | \$19,025 | (3) |
| Percentage of revenue | 16 % | 17 % | | 18 % | 20 % | |

Three months - 2018 compared to 2017. Sales and marketing expenses decreased by \$0.5 million, or 8%, in the third quarter of 2018 as compared with same period in 2017. The decrease was primarily the result of lower professional service fees and travel costs.

Nine months - 2018 compared to 2017. Sales and marketing expenses decreased by \$0.5 million, or 3% for the first nine months of 2018 as compared with same period in 2017. The decrease was primarily the result of lower professional service fees, lower travel costs and decreases in tradeshow and conference expenses.

General and Administrative Expenses

| | Three Months Ended | | | Nine Months Ended | | |
|----------------------------|--------------------|---------|----------|--------------------|----------|----------|
| | September 30, 2018 | 2017 | % Change | September 30, 2018 | 2017 | % Change |
| | (in thousands) | | | (in thousands) | | |
| General and administrative | \$5,279 | \$4,495 | 17 | \$14,616 | \$12,820 | 14 |
| Percentage of revenue | 15 % | 12 % | | 14 % | 14 % | |

Three months - 2018 compared to 2017. General and administrative expenses increased by \$0.8 million, or 17%, for three months ended September 30, 2018 as compared with the same period in 2017 due to higher professional service fees and severance costs related to restructuring activities, which were partially offset by decreased facility costs.

Nine months - 2018 compared to 2017. General and administrative expenses increased by \$1.8 million, or 14%, in the nine months ended September 30, 2018 as compared with the same period in 2017. This was primarily due to higher professional service fees and severance costs related to restructuring activities, which were partially offset by decreased facility costs.

Depreciation and Amortization Expense

| | Three Months Ended September 30, 2018 | | | September 30, 2017 | | | % Change | | |
|-------------------------------|---------------------------------------|---------|-----|--------------------|---------|---|----------------|---|--|
| | (in thousands) | | | (in thousands) | | | (in thousands) | | |
| Depreciation and amortization | \$2,437 | \$2,596 | (6) | \$7,316 | \$7,004 | 4 | | | |
| Percentage of revenue | 7 | % | 7 | % | 7 | % | 7 | % | |

Three months - 2018 compared to 2017. Depreciation and amortization decreased by \$0.2 million, or 6%, for the three months ended September 30, 2018 as compared to the same period in 2017 as the effect of increased depreciation of capitalized software development costs and other fixed assets was partially offset by the effect of assets becoming fully depreciated.

Nine months - 2018 compared to 2017. Depreciation and amortization increased by \$0.3 million or 4% for the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017 as the effect of increased depreciation of capitalized software development costs and other fixed assets was offset by the effect of assets becoming fully depreciated.

Other (Expense) Income

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|------------------------|---------------------------------------|-------|--------------------------------------|--------|
| | (in thousands) | | (in thousands) | |
| Other (expense) income | \$(32) | \$ 99 | \$(46) | \$ 172 |

Other (expense) income consists of interest income and foreign currency transaction and measurement gains and losses related to our international operations. The decreases for both the three and nine months ended September 30, 2018 over the corresponding periods in 2017 were due to realized foreign currency transaction loss in the third quarter of 2018.

Interest Expense

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|------------------|--|-------|-------------|---|-------|-------------|
| | 2018 | 2017 | % Change | 2018 | 2017 | % Change |
| | (in thousands) | | | (in thousands) | | |
| Interest expense | \$80 | \$127 | (37) | \$265 | \$328 | (19) |

Interest expense consists of interest on capital leases and long-term debt. Interest expense decreased in both the three and nine months ended September 30, 2018 over the comparable periods in 2017 primarily due to the May 2017 pay-off of our bank debt following our public stock offering.

Provision for Income Taxes

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|----------------------------|--|-------|-------------|---|-------|-------------|
| | 2018 | 2017 | % Change | 2018 | 2017 | % Change |
| | (in thousands) | | | (in thousands) | | |
| Provision for income taxes | \$165 | \$244 | (32) | \$478 | \$999 | (52) |

Provision for income taxes of \$0.5 million is comprised primarily of current foreign income tax expense, including foreign withholding taxes, offset by deferred income tax benefit. Prior to 2018, our U.S. deferred income tax assets were offset by valuation

allowances, and no benefit was recognized for our net operating losses. Additionally, there was deferred income tax expense due to deferred income tax liabilities related to intangible assets.

The Tax Cuts and Jobs Act eliminated the expiration period for U.S. net operating losses incurred in tax years beginning after 2017. As such, tax losses incurred for tax years beginning after 2017 are available to offset future taxable income that may result from the disposition of indefinite lived intangibles. The reduction of provision for income taxes from \$1.0 million in the nine-months ended September 30, 2017 to \$0.5 million in the nine-months ended September 30, 2018 reflects the effects of such deferred income tax benefit offsetting current foreign tax expense.

Liquidity and Capital Resources

Our primary liquidity and capital resource requirements are for financing working capital, investing in capital expenditures such as computer hardware and software, supporting research and development efforts, introducing new technology, enhancing existing technology, and marketing our services and products to new and existing customers.

To the extent that existing cash and cash equivalents, cash from operations, cash from short-term borrowings, and cash from the exercise of stock options are insufficient to fund our future activities, we may need to raise additional funds through public or private equity offerings or debt financings.

In September 2013, we entered into a Loan and Security Agreement with Silicon Valley Bank, or the Lender, which was amended most recently in September 2018 (as amended, the "Loan Agreement"). The amendment modified the terms of the financial covenants with which we must comply on a quarterly basis. The Loan Agreement provides for a \$12.0 million secured revolving line of credit with a stated maturity of January 23, 2019. The credit facility is available for cash borrowings, subject to a formula based upon eligible accounts receivable. As of September 30, 2018, we had no outstanding borrowings under the Loan Agreement, and we had \$11.8 million of availability based upon the borrowing formula under the Loan Agreement.

Any borrowings under the Loan Agreement bear interest, at our election, at an annual rate based on either the "prime rate" as published in The Wall Street Journal or LIBOR for the relevant period. If our liquidity coverage ratio (the ratio of cash plus eligible accounts receivable to borrowings under the Agreement) exceeds 2.75 to 1, LIBOR-based advances bear interest at LIBOR plus 3.5% and prime rate advances bear interest at the prime rate plus 1.0%. If our liquidity coverage ratio falls below 2.75 to 1, LIBOR-based advances bear interest at LIBOR plus 4.0% and prime rate advances bear interest at the prime rate plus 1.5%. For LIBOR advances, interest is payable (i) on the last day of a LIBOR interest period or (ii) on the last day of each calendar quarter. For prime rate advances, interest is payable (a) on the first day of each month and (b) on each date a prime rate advance is converted into a LIBOR advance.

Our obligations to the Lender are secured by a first priority security interest in all our assets, including our intellectual property. The Loan Agreement contains customary events of default, including non-payment of principal or interest, violations of covenants, material adverse changes, cross-default, bankruptcy and material judgments. Upon the occurrence of an event of default, the Lender may accelerate repayment of any outstanding balance. The Loan Agreement also contains certain financial covenants and other agreements that are customary in loan agreements of this type, including restrictions on paying dividends and making distributions to our stockholders. As of September 30, 2018, we were in compliance with the covenants and anticipate continuing to be so.

As of September 30, 2018, we had approximately \$15.7 million of cash and cash equivalents. We believe that our existing cash and cash equivalents, along with cash flows from operations and availability under our revolving credit line, will be sufficient to meet our anticipated working capital, interest payments, capital lease payment obligations, and capital expenditure requirements for at least the next 12 months.

Cash Flows

Statement of Cash Flows Data

| | September 30, | |
|---|----------------|------------|
| | 2018 | 2017 |
| | (in thousands) | |
| Net cash provided by (used in) operating activities | \$ 196 | \$(2,911) |
| Net cash used in investing activities | \$(5,271) | \$(3,129) |
| Net cash (used in) provided by financing activities | \$(1,482) | \$14,657 |

Net Cash Provided by (Used in) Operating Activities

During the nine months ended September 30, 2018, net cash provided by operating activities of \$0.2 million was primarily driven by a net loss of \$7.2 million and a decrease in working capital and other net assets of \$1.3 million which were offset by \$8.7 million of non-cash charges including depreciation, amortization, and stock-based compensation expense.

During the nine months ended September 30, 2017, net cash used in operating activities of \$2.9 million was primarily driven by a net loss of \$9.7 million which was only partially offset by a decrease in working capital and other net assets of \$0.8 million and \$7.6 million of non-cash charges including depreciation, amortization, stock-based compensation, and capital software impairment.

Net Cash Used in Investing Activities

Net cash used in investing activities totaled \$5.3 million in the nine months ended September 30, 2018, as compared to \$3.1 million in the comparable 2017 period. Cash payments were primarily for the development of internal-use software.

Net Cash (Used in) Provided by Financing Activities

Net cash used in financing activities for the nine months ended September 30, 2018 of \$1.5 million consisted of \$1.8 million of payments on capital lease obligations less \$0.3 million of proceeds from exercise of stock options.

Net cash provided by financing activities for the nine months ended September 30, 2017 of \$14.7 million primarily consisted of \$20 million from the offering of common stock and \$1.9 million of proceeds from the exercise of stock options, offset by a \$5.0 million repayment of long-term debt, \$1.3 million of deferred acquisition payments and \$0.9 million of payments on capital lease obligations.

Off-Balance Sheet Arrangements

As of September 30, 2018, we did not have any off-balance sheet arrangements, as defined in Item 303(a) (4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in our financial condition, revenue, or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have operations both within the United States and internationally, and we are exposed to market risks in the ordinary course of our business. These primarily include interest rate, inflation, and foreign currency exchange risk.

Interest Rate Risk

Our cash and cash equivalents primarily consist of cash and money market funds. We currently have no investments of any type. Our exposure to market risk for changes in interest rates is limited because nearly all of our cash and cash equivalents have a short-term maturity and are used primarily for working capital purposes.

Funds borrowed under the Loan Agreement bear interest at a variable annual rate, at our election, based on either the “prime rate” as published in The Wall Street Journal or LIBOR for the relevant period. If our liquidity coverage ratio (the ratio of cash plus eligible accounts receivable to bank borrowings under the related loan agreement) exceeds 2.75

to 1, LIBOR-based advances bear interest at LIBOR plus 3.5% and prime rate advances bear interest at the prime rate plus 1.0%. If our liquidity coverage ratio falls below 2.75 to 1, LIBOR-based advances bear interest at LIBOR plus 4.0% and prime rate advances bear interest at the prime rate plus 1.5%. This arrangement subjects us to interest rate risk. A 10% increase or decrease in these interest rates would not have a significant impact on our interest expense. Refer to Note 5, Long-Term Debt, of the Notes to the Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2017 for additional information about our outstanding debt.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Foreign Currency Exchange Risks

We are also subject to foreign currency exchange risk relating to our operations in Canada, Europe, India, Japan and Singapore. Our expenses at these locations are denominated in the local currencies and our results of operations are influenced by changes in the exchange rates between the U.S. Dollar and these local currencies, principally the Canadian Dollar, Euro, British Pound Sterling, Rupee, Yen, and Singapore Dollar. In addition, certain of our accounts receivable are denominated in currencies other than the U.S. Dollar, principally the Euro, British Pound Sterling and Japanese Yen. A 10% increase or decrease in the applicable currency exchange rates could result in an increase or decrease in our currency exchange (loss) gain of approximately \$0.2 million, calculated based on our foreign currency denominated accounts receivable as of September 30, 2018.

We have in the past, and we may in the future, enter into contracts to minimize the foreign currency exchange risk with respect to significant foreign currency denominated accounts receivable balances.

We continue to evaluate our various foreign currency exchange rate exposures and may take additional steps to mitigate these exposures.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2018. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Based on our management’s evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2018, our disclosure controls and procedures were not effective because of certain material weaknesses in our internal controls over financial reporting, as further described in our Annual Report on Form 10-K for our fiscal year ended December 31, 2017.

Notwithstanding these material weaknesses, we have concluded that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q present fairly, in all material respects, our financial position and results of operations and cash flows for the periods presented.

Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Remediation Efforts to Address the Material Weaknesses

We take these material weaknesses very seriously. While the identified material weaknesses were not remediated as of September 30, 2018, we have taken steps to remediate them and will continue to take further steps until their remediation is complete. For example, we have assigned additional personnel within our finance department to assist with the implementation, administration and evaluation of our internal control over financial reporting. These

additional personnel include certified public accountants and persons with experience in financial and accounting project management, to augment the experience and expertise of our accounting team. In addition, during the third quarter of 2018, we appointed a new Chief Financial Officer and hired a Senior Director of Accounting and a Manager of Financial Operations, all of whom are certified public accountants. We have also engaged an outside public accounting firm to provide us with the services of accounting support personnel and will continue to use their services on an as-needed basis.

Additionally, with the assistance of the outside public accounting firm, we are expanding and enhancing the written documentation of our internal controls, including assigning more specific responsibilities to particular personnel and imposing shorter timelines for executing their control-related tasks. The senior members of our finance department will be responsible for holding other members of the department accountable for meeting such timelines. We believe that this additional oversight, coupled with the additional personnel devoted to internal control over financial reporting, will allow us to execute business process controls more quickly and ensure a greater level of monitoring whether controls are present and functioning.

Changes in Internal Control over Financial Reporting

There were no other changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the quarter ended September 30, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are awaiting a decision of an arbitration tribunal following a binding arbitration that took place on July 30, 2018 between us and Maxit Technology Incorporated and Maxit Technology Holdings Limited, or Maxit, who were formerly the Company's joint venture partners in China. After unsuccessful settlement discussions between the parties, on January 25, 2016, Maxit requested arbitration under the Rules of the International Chamber of Commerce. In its request for arbitration, Maxit asserted claims for breach of contract, breach of the covenant of good faith and fair dealing, breach of fiduciary duty, and negligent misrepresentation, all arising out of our alleged failure to provide capital and software as required by the joint venture agreement. In its request, Maxit sought an award of money damages based on its share of the lost potential value of the joint venture, as well as a percentage of revenue from any future sales to customers originally introduced by Maxit, interest and legal expenses. Maxit alleges that its share of the lost potential value is approximately \$15 million. Based in part on an independent appraisal, we assessed the lost potential value at only \$0.6 million, for which half of this amount (based on 50/50 ownership) has been reserved in our financial statements. We contested Maxit's claims vigorously, and while it is not possible at this time to predict the outcome of the arbitration, we continue to believe that Maxit's claims are without merit. We anticipate a decision by the arbitration tribunal before the end of the calendar year 2018.

We and our Chief Executive Officer and former Chief Financial Officer were named as defendants in a federal securities class action lawsuit filed April 4, 2018 in the United States District Court for the Southern District of New York. The class includes persons who purchased Synacor's shares between May 4, 2016 and March 15, 2018. The plaintiff alleged that Synacor made materially false and misleading statements regarding its contract with AT&T and the timing of revenue to be derived therefrom, and that as a result class members suffered losses because Synacor shares traded at artificially inflated prices. The plaintiff sought an unspecified amount of damages, as well as interest, attorneys' fees and legal expenses. The court appointed a lead plaintiff and approved plaintiff's selection of lead counsel on July 6, 2018. On October 16, 2018 the court appointed new lead counsel and confirmed the lead plaintiff. The plaintiff filed an amended complaint on November 2, 2018. We dispute these claims and intend to defend them vigorously. The liabilities related to this lawsuit are covered by D&O insurance after we reach our deductible.

In addition, we are, from time to time, party to litigation arising in the ordinary course of our business. We do not believe that the outcome of these claims will have a material adverse effect on our consolidated financial position, results of operations or cash flows based on the status of proceedings at this time. However, regardless of the outcome, such proceedings can have an adverse impact on us because of defense and settlement costs, diversion of resources and other factors.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the risks discussed in "Part I, Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the "Form 10-K") and "Part II, Item 1A. Risk Factors" in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 (the "June Form 10-Q"). These risks and uncertainties have the potential to materially affect our business, financial condition, results of operation, cash flows, and future prospects. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may materially adversely impact our business, financial condition, or operating results. Except for the legal proceedings described above, we believe there have been no material changes from the risk factors previously disclosed in our Form 10-K as updated by the June Form 10-Q.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

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EXHIBIT INDEX

| Exhibit No. | Exhibit |
|-------------|--|
| 10.1* | <u>Seventh Amendment to Portal and Advertising Services Agreement effective as of August 23, 2018 between Synacor Inc. and AT&T Services, Inc.</u> |
| 31.1 | <u>Certifications of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2 | <u>Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1 | <u>Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Schema Linkbase Document |
| 101.CAL | XBRL Taxonomy Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Labels Linkbase Document |
| 101.PRE | XBRL Taxonomy Presentation Linkbase Document |

Notes:

*Confidential treatment has been requested for portions of this document. The omitted portions have been filed with the Securities and Exchange Commission.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SYNACOR, INC.
(Registrant)

Date: November 8, 2018 By: /s/ Himesh Bhise
Himesh Bhise
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 8, 2018 By: /s/ Timothy J. Heasley
Timothy J. Heasley
Chief Financial Officer and Secretary
(Principal Financial and Accounting Officer)