STAMPS.COM INC
Form 10-Q
August 08, 2017

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 June 30, 2017

OR

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

For the transition period from ____________ to ____________

Commission file number: 000-26427

Stamps.com Inc.
(Exact name of registrant as specified in its charter)

Delaware	77-0454966
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1990 E. Grand Avenue
El Segundo, California 90245
(Address of principal executive offices, including zip code)

(310) 482-5800
(Registrant's telephone number, including area code)

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

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

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

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

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

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

· As of July 31, 2017, there were 16,908,987 shares of the Registrant’s Common Stock issued and outstanding.

STAMPS.COM INC. AND SUBSIDIARIES
FORM 10-Q QUARTERLY REPORT FOR THE QUARTER ENDED JUNE 30, 2017

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 110,343	$ 106,932
Short-term investments	—	1,511
Accounts receivable, net	65,897	62,756
Other current assets	23,188	13,081
Total current assets	199,428	184,280
Property and equipment, net	38,199	36,829
Goodwill	239,705	239,705
Intangible assets, net	89,009	97,027
Deferred income taxes, net.	45,044	48,782
Other assets	5,127	3,506
Total assets	$ 616,512	$ 610,129
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 75,503	$ 86,205
Deferred revenue	3,851	3,858
Current portion of debt, net of debt issuance costs	7,360	6,329
Total current liabilities	86,714	96,392
Long-term debt, net of debt issuance costs	127,087	141,025
Total liabilities	213,801	237,417
Commitments and contingencies (Note 3)		
Stockholders' equity:		
Common stock, $.001 par value per share		
Authorized shares: 47,500 in 2017 and 2016		
Issued shares: 31,278 in 2017 and 30,507 in 2016		
Outstanding shares: 16,932 in 2017 and 16,897 in 2016	54	53
Additional paid-in capital	907,787	855,344
Treasury stock, at cost, 14,346 shares in 2017 and 13,610 in 2016	(341,699)	(252,981)
Accumulated deficit	(163,438)	(229,715)
Accumulated other comprehensive income	7	11
Total stockholders' equity	402,711	372,712
Total liabilities and stockholders' equity	$ 616,512	$ 610,129

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues:				
Service	$ 102,685	$ 72,590	$ 195,105	$ 141,696
Product	4,763	4,851	10,477	10,406
Insurance	4,393	4,082	8,833	8,593
Customized postage	4,276	2,467	6,718	5,104
Other	23	23	47	51
Total revenues	116,140	84,013	221,180	165,850
Cost of revenues (exclusive of amortization of intangible assets, which is included in general and administrative expense):				
Service	12,726	8,857	25,402	18,151
Product	1,593	1,642	3,395	3,440
Insurance	1,213	1,266	2,581	2,629
Customized postage	3,557	1,955	5,449	4,122
Total cost of revenues	19,089	13,720	36,827	28,342
Gross profit	97,051	70,293	184,353	137,508
Operating expenses:				
Sales and marketing	22,280	20,082	45,430	41,479
Research and development	11,628	8,131	22,150	16,468
General and administrative	21,451	17,113	40,433	32,375
Total operating expenses	55,359	45,326	108,013	90,322
Income from operations	41,692	24,967	76,340	47,186
Interest expense	(932)	(905)	(1,812)	(1,820)
Interest and other income	159	31	189	74
Income before income taxes	40,919	24,093	74,717	45,440
Income tax expense	9,879	9,802	10,539	17,911
Net income	$ 31,040	$ 14,291	$ 64,178	$ 27,529
Net income per share				
Basic	$ 1.83	$ 0.82	$ 3.79	$ 1.58
Diluted	$ 1.71	$ 0.79	$ 3.54	$ 1.49
Weighted average shares outstanding				
Basic	16,930	17,384	16,916	17,370
Diluted	18,125	18,192	18,147	18,428

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$ 31,040	$ 14,291	$ 64,178	$ 27,529
Other comprehensive income, net of tax:				
Unrealized (loss) gain on investments	(2)	(8)	(4)	4
Comprehensive income	$ 31,038	$ 14,283	$ 64,174	$ 27,533

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

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

	Six Months Ended June 30, 2017	2016
Operating activities:		
Net income	$ 64,178	$ 27,529
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,626	8,778
Stock-based compensation expense	22,335	15,933
Deferred income tax expense	5,838	16,055
Stock option windfall tax expense (benefit)	—	(307)
Accretion of debt issuance costs	186	186
Changes in operating assets and liabilities, net of assets and liabilities acquired:		
Accounts receivable	(3,140)	8,971
Other current assets, net of excess tax benefit from stock-based award activity	(10,107)	(2,233)
Other assets	(1,621)	741
Deferred revenue	(7)	1,405
Accounts payable and accrued expenses	(9,799)	4,784
Net cash provided by operating activities	78,489	81,842
Investing activities:		
Sale of short-term investments	1,502	3,632
Sale of long-term investments	10	66
Purchase of long-term investments	(4)	(15)
	—	(573)

Acquisition of Endicia						
Acquisition of property and equipment		(4,360	)		(701	)
Net cash (used in) provided by investing activities		(2,852	)		2,409	
Financing activities:						
Proceeds from short term financing obligation, net of repayments		(524	)		510	
Principal payments on term loan		(3,094	)		(2,061	)
Payment on revolving credit facility		(10,000	)		(10,000	)
Proceeds from exercise of stock options		28,641			7,042	
Issuance of common stock under Employee Stock Purchase Plan		1,469			1,108	
Repurchase of common stock		(87,919	)		(30,010	)
Shares withheld to satisfy statutory income tax withholding obligations		(799	)		—	
Stock option windfall tax benefit		—			307	
Net cash used in financing activities		(72,226	)		(33,104	)
Net increase in cash and cash equivalents		3,411			51,147	
Cash and cash equivalents at beginning of period		106,932			65,126	
Cash and cash equivalents at end of period	$	110,343		$	116,273	
Supplemental information:						
Capital expenditures accrued but not paid at period end	$	376		$	867	
Issuance of 2015 and 2014 earn-out shares	$	—		$	63,209	
	$	—		$	372	

Noncash adjustment of purchase price for Endicia acquisition		
Tenant improvement allowance	$ 848	$ 676

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

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

1. Summary of Significant Accounting Policies

Basis of Presentation

We prepared the consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures are adequate to make the information presented not misleading. We recommend that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in our latest annual report on Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on March 1, 2017.

In our opinion, these unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) considered necessary to present fairly our financial position as of June 30, 2017, our results of operations for the three and six months ended June 30, 2017, and our cash flows for the six months ended June 30, 2017. The results of operations for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2017.

Principles of Consolidation

The consolidated financial statements include the accounts of Stamps.com Inc., Auctane LLC (ShipStation), Interapptive, Inc. (ShipWorks), PSI Systems Inc. (Endicia), ShippingEasy Group, Inc. (ShippingEasy) and PhotoStamps Inc. In July 2016, we completed our acquisition of 100% of the outstanding shares of ShippingEasy.

Because 100% of the voting control of ShipStation, ShipWorks, Endicia and ShippingEasy is held by us, we have consolidated the results of operations of ShipStation, ShipWorks, Endicia and ShippingEasy from the date we obtained control in the accompanying consolidated financial statements. Similarly, due to our 100% control of PhotoStamps, Inc., PhotoStamps, Inc. is also consolidated in the accompanying consolidated financial statements from the date of its inception. Intercompany accounts and transactions between consolidated entities have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ from those estimates, and such differences may be material to the consolidated financial statements. Examples include estimates of loss contingencies, realizability of deferred income taxes, the estimates and assumptions used to calculate stock-based compensation, the estimates and assumptions used to calculate the allocation of the purchase price related to our acquisitions, and estimates regarding the useful lives of our building, amortizable intangible assets, and goodwill.

Business Combinations

The acquisition method of accounting is used for business combinations. The results of operations of acquired businesses are included in our consolidated financial statements prospectively from the date of acquisition. The fair

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

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

Contingencies and Litigation

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

Deferred Revenue

Our deferred revenue relates mainly to service revenue, which generally arises due to the timing of payment versus the provision of services for certain customers billed in advance.

Fair Value of Financial Instruments

Carrying amounts of certain of our financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate fair value due to their short maturities. The fair values of investments are determined using quoted market prices for those securities or similar financial instruments. The Company’s outstanding debt held by third-party financial institutions is carried at cost, adjusted for debt issuance costs. The Company’s debt is not publicly traded and the carrying amount typically approximates fair value for debt that accrues interest at a variable rate for companies with similar financial characteristics as the Company, which are considered Level 2 inputs.

Goodwill

Goodwill represents the excess of the fair value of consideration given over the fair value of the tangible assets, identifiable intangible assets and liabilities assumed in a business combination. We are required to test goodwill for impairment annually and whenever events or circumstances indicate the fair value of a reporting unit may be below its carrying value. Goodwill is reviewed for impairment annually on October 1. A reporting unit is the operating segment or a business that is one level below that operating segment. Reporting units are aggregated as a single reporting unit if they have similar economic characteristics. We aggregated our reporting units into a single reporting unit because we determined they have similar economic characteristics.

Goodwill is reviewed for impairment annually on October 1 utilizing either a qualitative assessment or a two-step process. We have an option to make a qualitative assessment of a reporting unit's goodwill for impairment. If we choose to perform a qualitative assessment and determine the fair value more likely than not exceeds the carrying value, no further evaluation is necessary. For reporting units where we perform the two-step process, the first step requires us to compare the fair value of each reporting unit, which we primarily determine using an income approach based on the present value of discounted cash flows, to the respective carrying value, which includes goodwill. If the fair value of the reporting unit exceeds its carrying value, the goodwill is not considered impaired. If the carrying value is higher than the fair value, there is an indication that impairment may exist and the second step is required. In step two, the implied fair value of goodwill is calculated as the excess of the fair value of a reporting unit over the fair values assigned to its assets and liabilities. If the implied fair value of goodwill is less than the carrying value of the reporting unit's goodwill, the difference is recognized as an impairment loss. As of June 30, 2017, we are not aware of any indicators of impairment that would require an impairment analysis other than our annual impairment analysis.

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

Impairment of Long-Lived Assets and Intangible Assets

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

Intangible assets that have indefinite useful lives are not amortized but, instead, are tested at least annually for impairment while intangible assets that have finite useful lives are amortized over their respective useful lives.

Income Taxes

We account for income taxes in accordance with Financial Accounting Standards Board (FASB) ASC Topic No. 740, Income Taxes (Income Taxes), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax basis of recorded assets and liabilities. Income Taxes also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the net deferred tax assets will not be realized. We record a valuation allowance to reduce our gross deferred tax assets to the amount that is more likely than not (a likelihood of more than 50 percent) to be realized. In order for us to realize our deferred tax assets, we must be able to generate sufficient taxable income. We evaluate the appropriateness of our deferred tax assets and related valuation allowance in accordance with Income Taxes based on all available positive and negative evidence. As of June 30, 2017 and December 31, 2016, we do not have any valuation allowance recorded to reduce our gross deferred tax assets as we believe we have met the more likely than not threshold and we will realize our tax loss carry-forwards in the foreseeable future.

Property and Equipment

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

Revenue Recognition

We recognize revenue from product sales or services rendered, as well as commissions from advertising or sale of products by third party vendors to our customer base when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the selling price is fixed or determinable; and collectability is reasonably assured.

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

Customers purchase postage from the USPS through our mailing and shipping solutions. Postage purchase funds that are transferred directly from the customers to the USPS are not recognized as revenue for this postage, as it is purchased by our customers directly from the USPS.

STAMPS.COM INC. AND SUBSIDIARIES
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(UNAUDITED)

Customized postage revenue, which includes the face value of postage, from the sale of PhotoStamps and PictureItPostage sh