SHUTTERFLY INC
Form 10-K
February 16, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2015

or

o	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 001-33031

SHUTTERFLY, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	94-3330068
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
2800 Bridge Parkway Redwood City, California	94065
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code
(650) 610-5200

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.0001 Par Value Per Share	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Rule 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

As of June 30, 2015, the last business day of our most recently completed second fiscal quarter, the aggregate market value of our Common Stock held by non-affiliates based on the closing price of our Common Stock on June 30, 2015 as reported on the NASDAQ Global Select Market was $1,779,261,915.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 11, 2016
Common stock, $0.0001 par value per share	34,855,162

DOCUMENTS INCORPORATED BY REFERENCE

Designated portions of the Proxy Statement relating to our 2016 Annual Meeting of the Stockholders (the "Proxy Statement") have been incorporated by reference into Part III (Items 10, 11, 12, 13 and 14) of this Form 10-K, as specified in the responses to the item numbers involved. Except for information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

Shutterfly, Inc.
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PART I

Except for historical financial information contained herein, the matters discussed in this annual report on Form 10-K may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Such statements include declarations regarding our intent, belief, or current expectations and those of management. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks, uncertainties and other factors, some of which are beyond our control; actual results could differ materially from those indicated by such forward-looking statements. Important factors that could cause actual results to differ materially from those indicated by such forward-looking statements include, but are not limited to: (i) that the information is of a preliminary nature and may be subject to further adjustment; (ii) those risks and uncertainties identified in this annual report on Form 10-K under “Risk Factors;” and (iii) the other risks detailed from time-to-time in our reports and registration statements filed with the Securities and Exchange Commission, or SEC. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1. BUSINESS.

Overview

Shutterfly, Inc. was incorporated in Delaware in 1999. In September 2006, we completed our initial public offering and our common stock is listed on the NASDAQ Global Select Market under the symbol “SFLY.” Our principal corporate offices are located in Redwood City, California.

We are the leading manufacturer and digital retailer of high-quality personalized products and services offered through a family of lifestyle brands. Our vision is to make the world a better place by helping people share life’s joy. Our mission is to build an unrivaled service that enables deeper, more personal relationships between our customers and those who matter most in their lives. Our primary focus is on helping consumers manage their memories through the powerful medium of photography. We provide a full range of personalized photo-based products and services that make it easy, convenient and fun for consumers to upload, edit, enhance, organize, find, share, create, print, and preserve their memories in a creative and thoughtful manner.

We operate trusted premium lifestyle brands: Shutterfly, Tiny Prints, Wedding Paper Divas, ThisLife, MyPublisher, BorrowLenses and Groovebook.

Shutterfly leads the market in digital personalized photo products and services. Shutterfly helps our customers turn their precious memories into lasting keepsakes with award-winning photo books, personalized holiday cards, announcements, invitations and stationery, as well as custom home decor products and unique photo gifts. Our online photo service helps our customers stay connected with family and friends, empowering them to do more with their pictures by expressing themselves in extraordinary ways.

Tiny Prints is a leading online cards and stationery boutique, offering stylish announcements, invitations and personal stationery for every occasion. Started by three friends with big dreams and a passion for beautiful paper, Tiny Prints has grown from a tiny self-funded company specializing in unique baby stationery to a booming online destination for stylish stationery, for every occasion. Customers (celebrities and top designers alike) seek us out for our fresh designs, premium paper and exceptional customer service. Tiny Prints makes it easy for customers to connect, keep in touch and transform life's joys into lasting impressions.

Wedding Paper Divas offers stylish and personalized save the dates, wedding invitations, thank you cards, bridal invitations and more—all designed by leading artists in the industry. Unlike most stationery brands, which simply provide a something-for-anyone offering, Wedding Paper Divas works with talented artists all over the country to translate the hottest new trends into perfectly unique products. Regardless of style or budget, Wedding Paper Divas offers better-than-boutique service with one-on-one design and etiquette expertise from wedding stationery specialists. Wedding Paper Divas uses the highest quality paper and offers a promise of complete satisfaction.

ThisLife is a service that gathers and organizes photos and videos and makes it easy to find, share and enjoy them anywhere. Its smart technology includes facial recognition, search functionality and easy photo importing. With ThisLife, our customers can easily manage their photos and find just the ones they want to turn into Shutterfly photo books, cards and gifts.

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MyPublisher is where our customers can create custom photo books, share great memories and tell their stories using their own photos. MyPublisher allows our customers to create, customize and share all of their favorite moments. We have a variety of book sizes for any occasion from our smallest Mini Books and Pocketbooks to our larger Classic and Deluxe Hardcovers.

BorrowLenses is a premier online marketplace for high-quality photographic and video equipment rentals. This service includes photo and video equipment rentals, sales of used photo and video equipment, exceptional customer service and dependable and convenient shipping and pick-up options.

Groovebook is a mobile photo book app subscription service that sends customers a keepsake book of their mobile photos each month.

We generate the majority of our revenues by producing and selling professionally-bound photo books, greeting and stationery cards, personalized calendars, other photo-based merchandise and high-quality prints ranging in size from wallet-sized to jumbo-sized 20x30 enlargements. We manufacture most of these items in our Fort Mill, South Carolina, Shakopee, Minnesota, and Tempe, Arizona production facilities. By controlling the production process in our own production facilities, we are able to produce high-quality products, innovate rapidly, maintain a favorable cost structure and ensure timely shipment to customers, even during peak periods of demand. Additionally, we sell a variety of photo-based merchandise that is currently manufactured for us by third parties, such as calendars, mugs, canvas prints, candles, pillows and blankets. We generate substantially all of our revenue from sales originating in the United States and our sales cycle has historically been highly seasonal as we generate more than 50% of our total net revenues during our fiscal fourth quarter.

Our high-quality products and services and the compelling online experience we create for our customers, combined with our focus on continuous innovation, have allowed us to establish premium brands. We realize the benefits of premium brands through high customer loyalty, low customer acquisition costs and premium pricing.

Our customers are a central part of our business model. They generate most of the content on our service by uploading their photos and storing their memories. In addition, they share their photos electronically with their friends and families, extending and endorsing our brand and creating a sense of community. Finally, by giving our branded products to colleagues, friends and loved ones throughout the year, customers reinforce our brands. Through these various activities, our customers create a viral network of new users and customers.

In addition to driving lower customer acquisition costs through viral marketing, our customers provide input on new features, functionalities and products. Close, frequent customer interactions, coupled with significant investments in sophisticated integrated marketing programs, enable us to fine-tune and tailor our promotions and website presentation to specific customer segments. Consequently, customers are presented with a highly personalized shopping experience, which helps foster a unique and deep relationship with our brands.

Segment Information

Our reportable segments are Consumer and Enterprise.

Consumer

Our Consumer revenues include sales from all of our brands and are derived from the sale of photo-based products, such as photo books, cards and stationery, photo gifts, home decor, photo prints, and the related shipping revenues as well as rental revenues from our BorrowLenses brand. Included in our photo-based merchandise are items such as mugs, iPhone cases, desktop plaques, candles, pillows, canvas prints and blankets. Photo prints consist of wallet, 4x6, 5x7, 8x10, square and large format sizes, such as posters and collages. In addition, Consumer revenues also include revenues from advertising and sponsorship activities. We also provide website services which include our share platform called Share Sites and our cloud-based service called ThisLife. Consumer revenues as a percentage of total net revenues were 91% in 2015, 95% in 2014 and 95% in 2013.

Enterprise

Our Enterprise revenues are derived from the printing and shipping of direct marketing and other variable data print products and formats. We provide Enterprise services primarily to the direct marketing industry. With the help of our large footprint of digital presses, we are building a scalable platform that enables our clients to optimize their integrated marketing campaigns. Enterprise revenues as a percentage of total net revenues were 9% in 2015, 5% in 2014 and 5% in 2013.

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For financial information about each segment, see Part II, Item 7 of this annual report on Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations-Basis of Presentation" and Part II, Item 8 of this annual report on Form 10-K, "Financial Statements and Supplementary Data-Notes to Consolidated Financial Statements-Note 13-Segment Reporting." For a discussion of the operational risks associated with each business segment, see Part I, Item 1A of this annual report on Form 10-K, "Risk Factors."

Business and Marketing Strategy

To support our business strategies within the Consumer segment, we use a variety of integrated marketing programs, including strategic marketing partnerships, e-mail marketing to prospects and existing customers, search engine marketing, search engine optimization, affiliate marketing, display advertising, traditional direct marketing mailings such as postcards and seasonal catalogs, print advertising, regional radio advertising, and a national cable TV campaign during the holiday season. In addition, because many of our products are either shared over the Internet or given as gifts, the appearance of our brands on the products and packaging provides ongoing viral advertising. We place targeted advertisements on websites and in publications, contract for targeted e-mail marketing services and contract for advertising placement on leading search engines. Within this segment, we seek to drive the following strategies:

- Focus on growing and optimizing our core brands.

We have a primary strategy to grow our core Shutterfly, Tiny Prints and Wedding Paper Divas brands by acquiring new customers, expanding the lifetime value of our existing customers, improving conversion rates, and introducing innovative new products. During 2015 we introduced dozens of innovative new products and services and attracted new customers with products like foil and glitter cards. Our customer loyalty remained high with approximately 75% of our revenues coming from repeat customers and increase in total transacting customers of 6%. Our top three consumer brands, Shutterfly, Tiny Prints and Wedding Paper Divas, grew through innovations in premium products and advertising. Shutterfly and Tiny Prints continued to delight customers and increase their loyalty to our industry-leading lineup of design-forward products and services. Both brands benefited from the popularity of our premium add-on options such as foil, envelope liners and special finishing touches; premium services, mobile and home decor. We also added several premium options such as designs on envelopes, colored envelopes and a variety of envelope liners in different designs, a selection of trim options to differentiate the card and take the edge off the hard corners, with for example, curves and scallops, as well as new address labels.

Home décor continued its strong growth with new products such as new ornaments and wall art. We launched Art Prints, featuring high quality wall art in various mediums with an option to upgrade to higher quality paper. Art Library, our curated offering with professional images, attracted many new customers. Furthermore, we also officially launched "Make My Book" in October, which offers customers the option of having us create their photo album for them, and which brought in new customers.

In Tiny Prints, we launched a new glitter offering with glitter that stays on the card, not the floor, which was exclusive to Tiny Prints in the marketplace. We focused on providing full solutions or "suites" that helped our customer stand out - at the mailbox and from the crowd. Our customer cares about the details, and we made it easy for them to add premium features such as liners and colored or themed envelopes, including designs on the back, which lifted average order value (AOV).

New products in Wedding Paper Divas included premium designs under the "Affordable Luxury" category - foil products, a re-launch of thermography and personalized letterpress and an expanded laser cut collection. We went to market with a simpler free sample kit which drove sample growth and reduced the time to get the product in the customers' hands. Wedding Paper Divas also benefited from coordinated marketing messages to reinforce the affordability of our products and increased direct mail touchpoints to encourage purchase. We also launched a new campaign “True to the Two of You” - real world couples are about the couple and not just the bride.

These innovations are on top of the success in 2014, during which we increased total transacting customers 6%, and launched several new products including ¾ folded cards, premium card options like foil-stamping and edge treatments, and metal and glass prints. We also introduced laser-cut cards and letterpress on our Tiny Prints brand. In addition, we introduced a new shopping experience for our home décor collection called Design Studio. Design Studio supports ecommerce and conversion by enabling a more personalized and tailored shopping experience by room, style, or decoration, as well as adding styling tips and do-it-yourself ideas. And, in 2013, we acquired BorrowLenses and MyPublisher and began to introduce their customer base to the other products and services of our Shutterfly and Tiny Prints brands.

• Invest in early stage strategic growth initiatives.

We have made investments in key, early stage initiatives. In 2014, we acquired Groovebook, a mobile photo book app subscription service that sends customers a keepsake book of their mobile phone photos each month. Groovebook continues our commitment to offering customers dynamic mobile experiences and options for preserving their memories. Also in 2014, we continued to improve our mobile experience adding new features and functionality to our existing apps on iOS, Android and Kindle devices. We completely redesigned our Share sites iPhone app, added new styles, fonts and a dust cover options to our Photo Story iPad app which we originally launched in 2013, and unveiled a “Super Simple Book” creation path on our Shutterfly iPhone app, providing mobile users the ability to create, personalize and order a 20-page, 8x8 hardcover photo books in just minutes. We also launched our first Tiny Prints mobile app allowing customers to explore, create and send customized holiday cards, stationery, and gifts from their iPad. In 2015, the percentage of revenues coming from mobile sources for the Shutterfly brand increased to 13% from 10% in 2014. We improved our customers’ mobile experiences, adding new features, functionality and products to apps in 2015 with new innovations such as a universal iOS mobile app. We also made several new products available to mobile customers such as playing cards, fleece blankets, pillows and metal ornaments. We will continue to introduce more features and products to mobile to capture the growing mobile opportunity.

In 2015, we discontinued the Treat brand. Treat was originally launched as an early stage growth initiative over three years ago, and during that time we invested in building a distinct one-to-one card experience that has delighted our customers, but that failed to attract a large enough standalone user base. However, customers will be redirected to Shutterfly.com where we enhanced the one-to-one card experience under our flagship brand identity.

We also made progress toward our vision of creating a world-class memory management service connected to the smartest personalized e-commerce solutions, what we’re calling Shutterfly 3.0. By modernizing our technology platform and introducing new customer-friendly features, we aim to address the friction points caused by multiple devices, fragmented storage options, and limited organization and search capabilities for interacting with photos and videos. The 3.0 initiative also includes delivering a better overall user experience with more products and innovations to our customers. This experience will eventually be portable to partners, enabling us to offer third parties the ability to leverage our platform to better serve their customers. Phase one, integrating ThisLife into Shutterfly, is underway, and we will begin migrating customers to the new, integrated platform in Q1 2016 and will continue this process throughout 2016. ThisLife’s features and functionality will improve the customer experience (one service, one site, one set of apps, and one well-known brand) and drive greater usage. Concurrently, we will be making other improvements to our mobile capabilities and our site to enable it to scale for the full 3.0 platform throughout 2016.

We intend to continue our efforts to make improvements in our platform and infrastructure including our big data strategy and analytics, e-commerce development, and manufacturing scale and automation. In particular, the scale and scope economies from our vertically integrated manufacturing and supply chain enable us to extend our competitive position and improve overall customer satisfaction, further strengthening the barriers to success in our industry. We made great progress in optimizing our manufacturing capabilities and supply chain - the significant scale and scope economies from our vertically integrated manufacturing and supply chain enable us to extend our competitive position, drive industry leading profitability and improve overall customer satisfaction.

In the second quarter of 2015, we opened our new production facility in Tempe, Arizona, adding a Southwest facility to the Shakopee, Minnesota Midwestern facility which opened in second quarter of 2014 and the Southern Fort Mill facility in South Carolina opened in second quarter of 2013. The combination of these three facilities enables us to deliver faster to customers, achieve an additional level of network redundancy, reduce shipping costs, minimize time to market for new product introductions and enable wider SKU insourcing. We brought over 10 products in-house in 2015, including mousepads, metal prints, playing cards and magnets. Through the insourcing process we rethink, innovate and improve on product quality delighting our customers and capturing more margin.

Also in 2015, we closed our manufacturing operations at the Elmsford, New York facility that was acquired with the MyPublisher acquisition. Although the Elmsford team produced a high quality product, the small size of the facility relative to our other facilities limited its ability to scale and drive efficiencies. The manufacturing work done in Elmsford was transitioned to our Fort Mill, Tempe and Shakopee facilities. We ceased manufacturing operations and customer service in Elmsford in the third quarter of 2015. While the back-end manufacturing operations for MyPublisher have been distributed to our three larger facilities, the MyPublisher brand will continue to operate as a key part of our portfolio of brands, with business, technology, and marketing operations remaining in New York state.

- Expand and enhance our brand equity.

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We seek to delight our customers by offering robust solutions and to expand and enhance our brand equity through all consumer touch points - marketing, business development, multi-brand site experiences and customer service. Throughout 2015, we deployed dozens of highly integrated channel campaigns with a balance of direct response and brand awareness that generated increased marketing efficiencies and enabled the company to reach new levels of brand awareness and engagement. We continued our philanthropic partnership with Ellen DeGeneres and our marketing partnership with Baby2Baby, a non-profit that supports low income babies and families. With respect to our major partners, we became the official photo partner for Carnival Cruises. Our promotional offers are integrated into Carnival's onboard photo rewards program. We expanded our catalog distribution to new and prospective customers and aired a television campaign after an inaugural launch in 2014. We also launched a first-time radio campaign in several metro markets. Lastly, we continue to work closely with our key advertising partners, participating in new programs such as Facebook's Instagram platform.

- Attract, retain, and grow our leadership team.

In order to successfully execute our strategies, we require a talented leadership team. As a result, we intend to continue our focus to attract, retain, and grow our team; and to build continuity and pursue executional excellence in our daily operations everywhere. By providing our employees with a great place to work, we believe that we continue to strengthen our high performance culture.

In December 2015, our President and Chief Executive Officer and our Senior Vice President and Chief Operating Officer announced that they will be leaving the Company on February 19, 2016. We have not hired a replacement Senior Vice President and Chief Operating Officer. Our Chairman of the Board, Phil Marineau, will serve as the interim Chief Executive Officer. Our search process to identify a candidate for a permanent Chief Executive Officer and President continues, and we continue to work with an executive search firm to assist with the process of identifying, evaluating and recruiting candidates.

- Maintain financial discipline.

We manage our business activities with a focus on continued revenue and profitability growth. Our financial strategy involves growing revenues across our brands and initiatives to take advantage of the multi-billion dollar social expression and personal publishing markets, but in a way that generates continued adjusted EBITDA growth. We define adjusted EBITDA as earnings before interest, taxes, amortization, and stock-based compensation.

Enterprise

In Enterprise, or Shutterfly Business Solutions (SBS), we continue to expand programs with existing customers while also targeting new customers. We continue to focus our efforts in expanding our presence in this market. Our strong performance in 2015 was achieved through better scope and scale efficiencies, automation and more focused sales. In 2015, SBS signed a seven-year contract valued at up to $350 million revenue with a major customer. The team produced record volumes for this customer in 2015, which we delivered at an outstanding on-time rate. SBS achieved this performance while servicing our current customers and attracting new clients. Customers are coming to SBS because they value that we are much more than a traditional printer. We are an integrated marketing partner and with the help of our large footprint of digital presses, we are building a scalable platform that enables our clients to optimize their integrated marketing campaigns. We believe our platform investments will further differentiate SBS and position us to capitalize on an important new market opportunity.

Technology and Production Systems

We use a combination of proprietary and third-party technology, including the following:

Customer relationship management or CRM system. Our integrated CRM system is composed of various tools designed to convert first-time customers into repeat buyers. We seek to increase average order sizes by expanding customer awareness, providing targeted, segmented offers to customers, and encouraging cross- and up-selling. The system uses a variety of data, including website usage patterns, order size, order frequency, products purchased, seasonality factors, image upload, and share usage, as well as customer satisfaction information. This data is continually updated and refreshed in a data warehouse, from which different customer segments are identified and monitored on a continuing basis for targeted marketing communications.

By using this deep customer intelligence and ongoing analysis, we are able to offer customers a more personalized website experience and to target them with specific website promotions, discounts, specialized e-mail, and direct mail offers. Our promotion engine generates special offers that are account specific and applied automatically at checkout.

We are also able to dynamically assign visitors to test and control groups who are shown different versions of our service. This form of A-B testing enables us to continuously optimize products, pricing, promotions, and user interaction with our websites.

Website system. We have designed our website systems to be secure and highly available within a data center, and not across geographically isolated data centers. We can scale to increasing numbers of customers cost-effectively by adding relatively inexpensive industry-standard computers and servers. We have a strong commitment to our privacy policy, and we utilize technologies such as firewalls, encryption technology for secure transmission of personal information between customers' computers and our website system and intrusion detection systems.

Image archive. We store our customers' images in our image archive. Once a customer uploads a photo to our website, it is copied to highly redundant systems. We continue to expand our storage capacity to meet increasing customer demand. Our innovative storage architecture provides low storage costs, facilitates the safe, secure archiving of customers' images and delivers the speed and performance required to enable customers to access, enhance and edit their images in real-time.

Render farm. Once a customer orders a photo or any photo-based product, our render farm technology performs fully automated image processing on the image prior to production. Except for 4x6 prints, the customer's original uploaded image is retrieved from the image archive, and automatic algorithms enhance the color, contrast and sharpness of the image. The render farm also performs customer-requested edits such as crop, borders, customized back-printing and red-eye removal.

To ensure that output is of consistent quality, we apply our proprietary ColorSure technology during this render stage. ColorSure creates an automated mapping of the image's specific attributes to the printer's specific print calibrations and attributes, prior to production. For example, this technology allows a 4x6 print to look the same as a photo printed on an enlargement or in a photo book, even if they are ordered at separate times.

Production system. We operate our own production facilities in Fort Mill, South Carolina; Tempe, Arizona; and Shakopee, Minnesota. Our automated production system controls our production processes, including order management and pick, pack and ship operations. Using proprietary algorithms, the production system analyzes tens of thousands of orders daily and automates the workflow into our state-of-the-art digital presses.

Shutterfly 3.0. We are making progress toward our vision of creating a platform and device agnostic world-class memory management service connected to the smartest personalized e-commerce solutions. We call that Shutterfly 3.0. By modernizing our technology platform, focusing on mobile and introducing new customer-friendly features, we aim to address the friction points caused by multiple devices, fragmented storage options, and limited organization and search capabilities for interacting with photos and videos. The 3.0 initiative also includes delivering a better overall user experience with more products and innovations to our customers. This experience will eventually be portable to partners, enabling us to offer third parties the ability to leverage our platform while better serving their customers and creating a revenue and profit stream.

Competition

The market for digital photography products and services is large, evolving, and intensely competitive, and we expect competition to increase in the future. We face intense competition from a wide range of companies, including the following:

- Online digital photography services companies such as Snapfish, Vistaprint, and many others;

Social media companies that host and enable mobile access to and posting of images such as Facebook, Instagram, Twitter, Pinterest, Snapchat and Google+;

Photo hosting websites that allow users to upload and share images at no cost such as Apple iCloud, Google Photos, and Flickr;

“Big Box” retailers such as Wal-Mart, Costco, Sam’s Club, Target, and others that offer low cost digital photography products and services. In addition to providing low-cost competitive product offerings on their respective websites, these competitors provide in-store fulfillment and self-service kiosks for printing, and may, among other strategies, offer their customers heavily discounted in-store products and services that compete directly with our offerings;

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- Drug stores such as Walgreens, CVS/pharmacy, and others that offer low-cost photography products and services as well as in-store pick-up from their photo website Internet orders;
- Traditional offline stationary companies such as PaperSource, Crane & Co., and Papyrus;
- Cloud-based storage services and file-syncing services such as Dropbox, Box, and Amazon Cloud Drive;
- Specialized companies in the photo book and stationery business such as Hallmark, Cardstore by American Greetings, Minted, Invitations by Dawn, Picaboo, Blurb, Mixbook, Zazzle, CafePress, Postable, and Artifact Uprising;
- Photo-related software companies such as Apple, Microsoft, and Adobe;
- Providers of digital alternatives to our products, such as Paperless Post, Evite, Animoto, and PicCollage.
- Home printing service providers such as Hewlett-Packard and Epson that are seeking to expand their printer and ink businesses by gaining market share in the digital photography marketplace;
- Enterprise digital and print communications companies such as RR Donnelley and Sons Company, O'Neil Data Systems, Inc., Quad/Graphics, Inc. and Viatech Publishing Solutions, Inc.;
- Regional photography companies such as Ritz Camera that have established brands and customer bases in existing photography markets; and
- Camera and photographic supply companies that rent equipment nationwide both online and in brick-and-mortar stores such as LensRentals.com, LensProToGo, Cameralends, AbelCine, and Adorama.

We believe the primary competitive factors in attracting and retaining customers are:

- brand recognition and trust;
- quality of products and services;
- breadth of products and services;
- user affinity and loyalty;
- customer service;
- ease of use;
- convenience; and
- price.

We believe that we compete favorably with respect to many of these factors, particularly customer trust and loyalty, quality and breadth of products and services, and customer service. Many of our competitors promote their products on the basis of low prices or the convenience of same-day availability for digital photos printed in drugstores or other retail outlets. Generally, we distinguish ourselves from such competitors principally on the basis of product quality and innovation, rather than price or same-day delivery.

Intellectual Property

Protecting our intellectual property rights is part of our strategy for continued growth and competitive differentiation. We seek to protect our proprietary rights through a combination of patent, copyright, trade secret and trademark law. We enter into confidentiality and proprietary rights agreements with our employees, consultants and business partners, and control access to and

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distribution of our proprietary information. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights to third parties.

As of December 31, 2015, we had 88 issued patents, which expire at various dates between 2019 and 2033, and more than 30 patent applications pending in the United States. Our issued patents and patent applications relate primarily to intelligent product creation; image uploading, sharing, and editing; ordering and sharing products; cloud image storage infrastructure; manufacturing optimization; mobile and social media technologies; and automated and personalized manufacturing. We intend to pursue corresponding patent coverage in additional countries to the extent we believe such coverage is appropriate and cost efficient. However, we cannot be certain that any of our pending or any future applications will be granted. In addition, third parties could bring invalidity, co-inventorship or similar claims with respect to any of our currently issued patents or any patents that may be issued to us in the future.

Our primary brands are “Shutterfly,” “Tiny Prints,” and “Wedding Paper Divas.” We hold applications and/or registrations for the Shutterfly, Tiny Prints, and Wedding Paper Divas trademarks in our major markets of the United States and Canada, as well as in the European Community. We also hold applications and registrations for the Shutterfly mark in Mexico, Japan and China, and for the Shutterfly and Tiny Prints marks in Australia and New Zealand. We own the domains Shutterfly.com, TinyPrints.com, WeddingPaperDivas.com and Groovebook.com among others.

Government Regulation

The legal environment of the Internet is constantly evolving in the United States and elsewhere. The manner in which existing laws and regulations will be applied to the Internet in general, and how they will relate to our business in particular, is unclear in many cases. Accordingly, we often cannot be certain how existing laws will apply in the online context, including with respect to such topics as privacy, defamation, pricing, credit card fraud, advertising, taxation, sweepstakes, promotions, content regulation, net neutrality, quality of products, and services and intellectual property ownership and infringement. In particular, legal issues relating to the liability of providers of online services for activities of their users are currently unsettled both within the United States and abroad.

Numerous laws have been adopted at the national and state level in the United States that could have an impact on our business. These laws include the following:

- The CAN-SPAM Act of 2003 and similar laws adopted by a number of states. These laws are intended to regulate unsolicited commercial emails, create criminal penalties for unmarked sexually-oriented material and e-mails containing fraudulent headers and control other abusive online marketing practices.
- The Communications Decency Act, which gives statutory protection to online service providers who distribute third-party content.
- The Digital Millennium Copyright Act, which is intended to reduce the liability of online service providers for listing or linking to third-party websites that include materials that infringe copyrights or other rights of others.
- The Children's Online Privacy Protection Act and the Prosecutorial Remedies and Other Tools to End Exploitation of Children Today Act of 2003, which are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.
- Statutes adopted in the State of California and other states, require online services to report certain breaches of the security of personal data, and to report to consumers when their personal data might be disclosed to direct marketers.

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- The federal Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD Act") includes provisions governing the use of gift cards, including specific disclosure requirements and a prohibition or limitation on the use of expiration dates and fees. Each state regulates gift cards in its own manner, so long as in concert with the CARD Act. Several states are attempting to pass new laws regulating the use of gift cards and amending state escheatment laws to try to pass new laws regulating the use of gift cards and amending state escheatment laws to try and obtain unused gift card balances.
- The Restore Online Shoppers' Confidence Act ("ROSCA") prohibits and prevents Internet-based post-transaction third party sales and imposes specific requirements on negative option features.
- The Patient Protection and Affordable Care Act (the "Patient Act"), as well as other healthcare reform legislation being considered by Congress and state legislatures. Changes to our healthcare costs structure could increase our employee healthcare-related costs.

To resolve some of the remaining legal uncertainty, we expect new U.S. and foreign laws and regulations to be adopted over time that will be directly or indirectly applicable to the Internet and to our activities. In addition, government agencies may begin regulating previously unregulated Internet activities or applying existing laws in new ways to providers of online services. Moreover, the law relating to the liability of providers of online services for activities of their users and business partners is currently unsettled both within the United States and abroad. Any existing or new legislation applicable to us could expose us to government investigations or audits, prosecution for violations of applicable laws and/or substantial liability, including penalties, damages, significant attorneys’ fees, expenses necessary to comply with such laws and regulations or the need to modify our business practices. From time to time, claims may be threatened against us for aiding and abetting, defamation, negligence, copyright or trademark infringement, or other theories based on the nature and content of information to which we provide links or that we or others post online. On a more general level, government regulation of the Internet could dampen the growth in the use of the Internet, have the effect of discouraging innovation and investment in Internet-based enterprises or lead to unpredictable litigation.

We post on our websites our privacy policies and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policies, Federal Trade Commission requirements or other privacy-related laws and regulations could result in proceedings that could potentially harm our business, results of operations and financial condition. In this regard, there are a large number of federal and state legislative proposals before the United States Congress and various state legislative bodies regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, such as required use of disclaimers, if adopted, could harm our business through a decrease in user registrations and revenues.

Employees

As of December 31, 2015, we had 2,016 full time employees. Below is a summary of employees by function as of December 31, for each of the last three years:

	2015	2014	2013
Cost of revenue	999	905	755
Technology and development	560	477	428
Sales and marketing	272	259	250
General and administrative	185	171	140
Total	2,016	1,812	1,573

During the peak holiday season, we hire contract workers on a temporary basis from third-party outsourcing firms. For example, during our peak production period in the fourth quarter of 2015, we used approximately 3,500 temporary workers to assist in our production and fulfillment operations. None of our employees are represented by a labor union or are covered by a collective bargaining agreement. We have never experienced any employment-related work stoppages and consider our employee relations to be good.

Available Information

Our Internet website is located at http://www.shutterflyinc.com. The information on our website is not a part of this annual report on Form 10-K. We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the

Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). Our SEC reports can be accessed through the investor relations section of our Internet website.

The public may also read and copy any materials we file with the Securities and Exchange Commission at the Securities and Exchange Commission's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission also maintains an Internet website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the Securities and Exchange Commission. The Securities and Exchange Commission's Internet website is located at http://www.sec.gov.

ITEM 1A. RISK FACTORS

Risks Related to Our Business and Industry

Our net revenues, operating results and cash requirements are affected by the seasonal nature of our business.

Our business is highly seasonal, with a high proportion of our net revenues, net income and operating cash flows generated during the fourth quarter. For example, we generated more than 50% of our net revenues in the fourth quarter during each of the last three years. In addition, we incur significant additional expenses in the period leading up to the fourth quarter holiday season including expenses related to the hiring and training of temporary workers to meet our seasonal needs, additional inventory and equipment purchases, and increased advertising. If we are unable to accurately forecast and respond to consumer demand for our products during the fourth quarter, our financial results, reputation and brands will suffer and the market price of our common stock would likely decline.

We also base our operating expense budgets on expected net revenue trends. A portion of our expenses, such as office, production facility, and various equipment leases and personnel costs, are largely fixed and are based on our expectations of our peak levels of operations. We may be unable to adjust spending quickly enough to offset any unexpected revenue shortfall. Accordingly, any shortfall in net revenues may cause significant variation in operating results in any quarter.

If we are unable to meet our production requirements, our net revenues and results of operations would be harmed.

We believe that we must continue to grow our current production capability to meet our projected net revenue targets. Our capital expenditures were approximately 8%, 10% and 10% of total net revenues for the years ended December 31, 2015, 2014 and 2013, respectively. We anticipate that total capital expenditures for the year ending December 31, 2015 will range from 7% to 8% of 2016 net revenues. Operational difficulties, such as a significant interruption in the operations of our Fort Mill, South Carolina; Tempe, Arizona; or Shakopee, Minnesota production facilities, could delay production or shipment of our products. In addition, inclement weather, particularly heavy rain and snow could impair our production capabilities. Our inability to meet our production requirements could lead to customer dissatisfaction and damage our reputation and brands, which would result in reduced net revenues. Moreover, if the costs of meeting production requirements, including capital expenditures, were to exceed our expectations, our results of operations would be harmed.

In addition, at peak holiday seasons, and in particular during the fourth quarter, we face significant production risks, including the risk of obtaining sufficient qualified seasonal production personnel. A majority of our workforce during the fourth quarter of 2015 was seasonal, temporary personnel. We have had difficulties in the past finding a sufficient number of qualified seasonal employees, and our failure to obtain qualified seasonal production personnel at any of our production facilities could harm our operations.

Uncertainties in general economic conditions and their impact on consumer spending patterns, particularly in the personalized products and photofinishing services categories, could adversely impact our operating results.

Our financial performance depends on general economic conditions in the United States and their impact on levels of consumer spending, particularly spending on personalized products and photofinishing services. Consumer revenue as a percentage of total revenue was 91% in 2015, 95% in 2014 and 95% in 2013. Some of the macroeconomic conditions that can adversely affect consumer spending levels in the United States include domestic and foreign stock market volatility and its effects on net worth, anticipated economic slowdowns in foreign economies, high consumer debt levels, uncertainty in real estate markets and home values, fluctuating energy and commodity costs, rising or higher than average interest rates, higher than usual unemployment rates, limited credit availability and general uncertainty about the future economic environment. If general economic conditions do not improve or continue to improve slowly, customers or potential customers could delay, reduce or forego their purchases of our

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products and services, which are often discretionary. Any decrease in the demand for our products and services could impact our business in a number of ways, including lower prices for our products and services and reduced sales. In addition, adverse economic conditions may lead to price increases by our suppliers or increase our operating expenses due to, among other factors, higher costs of labor, energy, equipment and facilities which could in turn lead to additional restructuring actions by us and associated expenses. We may not be able to pass these increased costs on to our customers due to the macroeconomic environment and the resulting increased expenses and/or reduced income could have a material adverse impact our operating results.

Competitive pricing pressures, particularly with respect to pricing and shipping, may harm our business and results of operations.

Demand for our products and services is sensitive to price, especially in times of slow or uncertain economic growth and consumer conservatism. Many external factors, including our production and personnel costs, consumer sentiment and our competitors' pricing and marketing strategies, can significantly impact our pricing strategies. If we fail to meet our customers' price expectations, we could lose customers, which would harm our business and results of operations.

Changes in our pricing strategies have had, and may continue to have, a significant impact on our net revenues and net income. From time to time, we have made changes to our pricing structure in order to remain competitive. Most of our other products, including photo books, calendars, cards and stationery and other photo merchandise are also offered by our competitors. Many of our competitors discount those products at significant levels and as a result, we may be compelled to change our discounting strategy, which could impact our acquisition of new customers, average order value, net revenues, gross margin, and adjusted EBITDA and net income profitability measures. We experienced a greater level of discounting in 2015 than in past years. If in the future, due to competitor discounting or other marketing strategies, we significantly reduce our prices on our products without a corresponding increase in volume, it would negatively impact our net revenues and could adversely affect our gross margins and overall profitability.

We generate a significant portion of our net revenues from the fees we collect from shipping our products. For example, shipping revenue for the Shutterfly brand website represented approximately 20% of our net revenues in 2015 and 16% of our net revenues in 2014 and 2013. We offer discounted or free shipping, with a minimum purchase requirement, during promotional periods to attract and retain customers. If free shipping offers extend beyond a limited number of occasions, are not based upon a minimum purchase requirement or become commonplace, our net revenues and results of operations would be negatively impacted. In addition, we occasionally offer free or discounted products and services to attract and retain customers. In the future, if we increase these offers to respond to actions taken by our competitors, our results of operations may be harmed.

We face intense competition from a range of competitors and may be unsuccessful in competing against current and future competitors.

The digital photography products and services industry is intensely competitive, and we expect competition to increase in the future as current competitors improve their offerings, including developing, acquiring and expanding mobile and cloud-based offerings, and as new participants enter the market or as industry consolidation further develops. Competition may result in pricing pressures, reduced profit margins or loss of market share, any of which could substantially harm our business and results of operations. We face intense competition from a wide range of companies, including the following:

- Online digital photography services companies such as Snapfish, Vistaprint, and many others;
- Social media companies that host and enable mobile access to and posting of images such as Facebook, Instagram, Twitter, Pinterest, Snapchat and Google+;
-

Photo hosting websites that allow users to upload and share images at no cost such as Apple iCloud, Google Photos, and Flickr;

- "Big Box" retailers such as Wal-Mart, Costco, Sam's Club, Target, and others that offer low cost digital photography products and services. In addition to providing low-cost competitive product offerings on their respective websites, these competitors provide in-store fulfillment and self-service kiosks for printing, and may, among other strategies, offer their customers heavily discounted in-store products and services that compete directly with our offerings;
- Drug stores such as Walgreens, CVS/pharmacy, and others that offer low-cost photography products and services as well as in-store pick-up from their photo website Internet orders;
- Traditional offline stationary companies such as PaperSource, Crane & Co. and Papyrus;

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- Cloud-based storage services and file-syncing services such as Dropbox, Box, and Amazon Cloud Drive;
- Specialized companies in the photo book, photo merchandise and stationery business such as Hallmark, Cardstore by American Greetings, Minted, Invitations by Dawn, Picaboo, Blurb, Mixbook, Zazzle, CafePress, Postable, and Artifact Uprising;
- Photo-related software companies such as Apple, Microsoft, and Adobe;
- Providers of digital alternatives to our product such as Paperless Post, Evite, Animoto and PicCollage;
- Home printing service providers such as Hewlett-Packard and Epson that are seeking to expand their printer and ink businesses by gaining market share in the digital photography marketplace;
- Enterprise digital and print communications companies such as RR Donnelley and Sons Company, O'Neil Data Systems, Inc., Quad/Graphics, Inc. and Viatech Publishing Solutions, Inc.;
- Regional photography companies such as Ritz Camera that have established brands and customer bases in existing photography markets; and
- Camera and photographic supply companies that rent equipment nationwide both online and in brick-and-mortar stores such as LensRentals.com, LensProToGo, Cameralends, AbelCine, and Adorama.

Many of our competitors have significantly longer operating histories, larger and broader customer bases, greater brand and name recognition, greater financial, research and development and distribution resources, and operate in more geographic areas than we do. Well-funded competitors and competitors that operate large-scale businesses of which digital photography products and services are only an immaterial aspect of their overall business may be better able to withstand economic downturns and periods of slow economic growth and the associated periods of reduced customer spending and increased pricing pressures. The numerous choices for digital photography services can cause confusion for consumers, and may cause them to select a competitor with greater name recognition. Some competitors are able to devote substantially more resources to website and systems development or to investments or partnerships with traditional and online competitors. Well-funded competitors, particularly new entrants, may choose to prioritize growing their market share and brand awareness instead of profitability. Competitors and new entrants in the digital photography products and services industry may develop new products, technologies or capabilities that could render obsolete or less competitive many of our products, services and content. We may be unable to compete successfully against current and future competitors, and competitive pressures could harm our business and prospects.

Our quarterly financial results may fluctuate, which may lead to volatility in our stock price.

Our future revenues and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are difficult for us to predict and control. Factors that could cause our quarterly operating results to fluctuate include:

- general economic conditions, including stock market volatility, recession and slow economic growth in the United States and worldwide;
- rise of digital alternatives;
- demand for our products and services, including seasonal demand;
- our pricing and marketing strategies and those of our competitors;
- our ability to attract visitors to our websites and mobile applications and convert those visitors into customers;
- our ability to retain customers and encourage repeat purchases;
- the costs of customer acquisition;
- our ability to manage our production and fulfillment operations, in particular during the fourth quarter;
- the effect of cyber-attacks or other technological issues on our production and fulfillment operations, in particular during the fourth quarter;
- disruptions in our production and fulfillment capabilities and operations, in particular during peak seasonal times;
- the costs to produce our prints and photo-based products and merchandise and to provide our services;

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- the costs of expanding or enhancing our technology or websites;
- a significant increase in returns and credits, beyond our estimated allowances, for customers who are not satisfied with our products;
- our ability to achieve the expected benefits of strategic partnerships or the loss of any such partnership;
- declines or disruptions to the travel industry;
- declines in birth rates and weddings;
- variations in weather, particularly heavy rain and snow which tend to depress travel and picture taking;
- the timing of holidays and the duration of the holiday shopping season;
- our ability to address increased shipping delays caused by our third party shippers' inability to handle the ever increasing number of consumers ordering goods online, particularly during the holiday shopping season;
- volatility in our stock price, which may lead to higher stock-based compensation expense;
- consumer preferences for digital photography services;
- improvements to the quality, cost and convenience of desktop printing of digital pictures and products; and
- global and geopolitical events with indirect economic effects such as pandemic disease, hurricane and other natural disasters, war, threat of war or terrorist actions. For example, we have significant engineering resources in Haifa, Israel and any military actions in that part of the world may impact those resources.

Based on the factors cited above, we believe that sequential comparisons of our operating results are not a good indication of our future performance. It is possible that in one or more future quarters, our operating results may be below the expectations of public market analysts and investors. In that event, the trading price of our common stock may decline.

We have incurred operating losses in the past and may not be able to sustain profitability in the future.

We have periodically experienced operating losses since our inception in 1999. In particular, we make investments in our business that generally result in operating losses in each of the first three quarters of our fiscal year. This typically has enabled us to generate the majority of our net revenues during the fourth quarter and to achieve profitability for the full fiscal year. If we are unable to produce our products and provide our services at commercially reasonable costs, if consumer demand decreases and revenues decline or if our expenses exceed our expectations, we may not be able to achieve, sustain or increase profitability on a quarterly or annual basis.

We face many risks, uncertainties, expenses and difficulties relating to increasing our market share and growing our business.

To address the risks and uncertainties of increasing our market share and growing our business, we must do the following:

- maintain and increase the size of our customer base;
- maintain and enhance our brands and reputation;
- enhance and expand our products and services;
- maintain and grow our websites, mobile applications and customer operations;
- successfully execute our business and marketing strategies;
- continue to develop and upgrade our technology and information processing systems;
- continue to enhance and update our services to meet the needs of changing markets and consumer preferences;
- provide a high quality customer experience, including superior customer service and timely product deliveries;
- respond to competitive developments; and
- attract, integrate, retain and motivate qualified personnel.

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We may be unable to accomplish one or more of these requirements, which could cause our business to suffer. Pursuing and accomplishing one or more of these requirements may be very expensive and resource intensive, which could harm our financial results.

Our sales to Enterprise customers can be unpredictable and a decrease in Enterprise revenue could adversely impact total net revenue.

Enterprise net revenues as a percentage of total net revenues was 9% in 2015, 5% in 2014 and 5% in 2013. Our Enterprise net revenues are highly concentrated in a few customers and the loss of one or more of our Enterprise customers could significantly decrease Enterprise net revenues and adversely impact our total net revenues. Our Enterprise customers also come from a variety of industries, creating many regulatory compliance issues for us as well as the need to maintain security for third party data. These Enterprise customers also demand strict security requirements and specified service levels. If we fail to meet these security requirements or service levels, we may not only lose an Enterprise customer but may have to pay punitive costs for such failures. As our Enterprise business grows, issues that impact our sales to Enterprise customers may have a negative impact on our total sales. Our core business is consumer focused and we have less experience managing sales to Enterprise customers and may not sell as successfully to Enterprise customers, who often have long sales cycles, long implementation periods and significant upfront costs. To compete effectively in the Enterprise market, we have in the past, and may in the future, be forced to offer significant discounts to large Enterprise customers at lower margins and/or reduce or withdraw from existing relationships with smaller Enterprise customers, which could negatively impact our net revenues and could adversely affect our gross margins and overall profitability.

If we are not able to reliably meet our technology, data storage and management requirements, it may negatively impact customer satisfaction, revenue, costs and brand reputation.

As a part of our current business model, we offer our customers free unlimited online storage and sharing of images and, as a result, must store and manage many petabytes of data. This policy results in immense system requirements and substantial ongoing technological challenges, both of which are expected to continue to increase over time. We continuously evaluate our short and long-term data storage capacity requirements to ensure adequate capacity and management for new and existing customers. We strive to predict the capacity requirements as tightly as possible as overestimating may negatively impact our capital needs and underestimating may impact the level and quality of service we provide to our customers, which could impact customer satisfaction, revenue, costs and brand reputation.

If we do not successfully develop and implement Shutterfly 3.0 in a timely manner or if Shutterfly 3.0 is not accepted by our customers, our results of operations may suffer.

We have made progress toward creating a memory management service connected to smart, personalized, customer-friendly, scalable e-commerce solutions (“Shutterfly 3.0”). With Shutterfly 3.0, we aim to address the friction points caused by multiple devices, fragmented storage options and limited organization and search capabilities for interacting with photos and videos. Shutterfly 3.0 is intended to deliver a better overall user experience with more products and innovations for our customers. Phase one, integrating ThisLife into Shutterfly is being completed, and we will begin migrating customers to the new, integrated platform in first quarter of 2016 and will continue this process throughout 2016.

If we are unable to develop and implement Shutterfly 3.0 in a timely manner, or if it is not accepted by our customers, our ability to compete could be adversely affected and may result in the loss of market share, which would harm our results of operations. In addition, if Shutterfly 3.0 does not function as designed, we may experience a loss of confidence or lost sales from customers who are dissatisfied with the changes to our platform, which would adversely affect our reputation and results of operations.

Computer system capacity constraints and system failures could significantly degrade the quality of our services, such as access to our websites or mobile applications, and in-turn cause customer loss, damage to our reputation and negatively affect our net revenues.

Our business requires that we have adequate capacity in our computer systems to cope with the periodic high volume of visits to our websites and mobile applications. As our operations grow in size and scope, we continually need to improve and upgrade our computer systems, data storage, and network infrastructure to ensure reliable access to our websites and mobile applications, in order to offer customers enhanced and new products, services, capacity, features and functionality. The expansion of our systems and infrastructure may require us to commit substantial financial, operational and technical resources before the volume of our business increases, with no assurance that our net revenues will increase to offset these additional expenses.

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Our ability to provide high-quality products and service depends on the efficient and uninterrupted operation of our computer and communications, data storage and network infrastructure systems. If our systems cannot be scaled in a timely manner to cope with increased website and mobile applications traffic, we could experience disruptions in service, slower response times, lower customer satisfaction, and delays in the introduction of new products and services. Any of these problems could harm our reputation and cause our net revenues to decline.

Full or partial outages to our websites, mobile applications, computer systems, print production processes or customer service operations could damage our brand reputation and substantially harm our business and results of operations.

The satisfactory performance, reliability and availability of our websites and mobile applications, information technology systems, printing production processes and customer service operations are critical to our service delivery, customer acquisition and retention and brand reputation growth. Any service interruptions that degrade the satisfactory use of our websites and mobile applications due to undetected bugs, design faults or poor scalability, may impact customer growth and retention, revenue and costs. These include (but are not limited to) our product creation experience, order fulfillment performance, customer service operations and security of our systems.

This risk is heightened in the fourth quarter, as we experience significantly increased traffic to our websites during the holiday season and significantly higher order volumes. Any interruption that occurs during such time would have a disproportionately negative impact on our results of operations than if it occurred during a different quarter. For example, during the fourth quarter of 2014, unusually high seasonal traffic combined with system misconfigurations arising from our data center migration resulted in some days when customers could not place orders from our Tiny Prints brand. Even after the issue was identified and corrected, many of those orders were not received by customers within the expected time frame. As a result, we refunded many of those orders which reduced net revenues, recognized excess costs related to expedited shipping upgrades, and increased customer service costs which negatively impacted our gross margins and our brand.

We depend in part on third parties to implement and maintain certain aspects of our Internet and communications infrastructure and printing systems. Therefore many of the causes of system interruptions or interruptions in the production process may be outside of our control. As a result, we may not be able to remedy such interruptions in a timely manner, or at all. Our business interruption insurance policies do not address all potential causes of business interruptions that we may experience, and any proceeds we may receive from these policies in the event of a business interruption may not fully compensate us for the revenues we may lose.

An increasing number of our customers are using smartphones, tablets and other mobile devices to order products and access services. If we are unable to develop mobile applications that are adopted by our customers or if we are unable to generate revenue from our mobile applications, our results of operations and business could be adversely affected.

The number of people who access information about our services and our website through mobile devices, including smartphones and handheld tablets or computers, has increased significantly in recent years and is expected to continue increasing. As new mobile devices and platforms are released, it is difficult to predict the problems we may encounter in developing products for these alternative devices and platforms, and we may need to devote significant resources to the creation, support, and maintenance of such products. If we experience difficulties providing satisfactory access to our services via our mobile applications, such as, problems with our relationships with providers of mobile operating systems (e.g. Apple or Google and their application stores) our growth and customer acquisition and retention capabilities may be impaired. In addition, increased distribution costs of the applications may impact net revenue growth and negative reviews due to our software and user experience may damage our brand reputation and lead to customer churn.

Any failure by us to protect the confidential information of our customers and networks against security breaches and the risks associated with credit card fraud could damage our reputation and brands and substantially harm our business and results of operations.

A significant prerequisite to e-commerce and communications is the secure transmission of confidential information over public networks. Our failure to prevent security breaches could damage our reputation and brands and substantially harm our business and results of operations. For example, a majority of our sales are billed to our customers’ credit card accounts directly, orders are shipped to a customer’s address, and customers log on using their e-mail address. We rely on encryption and authentication technologies licensed from third parties to effect the secure transmission of confidential information, including credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography, hacking or other developments may result in a compromise or breach of the technology used by us to protect customer transaction data. In addition, any party who is able to illicitly obtain a user’s password could access the user’s transaction data, personal information or stored images. Our use of our own as third-party provided (such as Amazon) cloud based services could also increase the risk of security breaches as cyber-

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attacks on cloud environments are increasing to almost the same level as attacks on traditional information technology systems. For example, in 2014, we experienced a cyber-attack on our Tiny Prints, Treat and Wedding Paper Divas websites, which may have exposed the email addresses and encrypted passwords used by our customers to login to their accounts. We encrypt customer credit and debit card information, and we have no evidence that such information was compromised; however, any compromise of our security could damage our reputation and brands and expose us to a risk of loss or litigation and potential liability, which would substantially harm our business and results of operations. In addition, anyone who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may need to devote significant resources to protect against security breaches or to address problems caused by breaches.

In addition, contractors we hire as well as other employees have access to confidential information, including credit card data. Although we take steps to limit this access, this data could be compromised by these contractors or other employee personnel. Under current credit card practices, we are liable for fraudulent credit card transactions because we do not obtain a cardholder’s signature. We do not currently carry insurance against this risk. To date, we have experienced minimal losses from credit card fraud, but we continue to face the risk of significant losses from this type of fraud. Our failure to adequately control fraudulent credit card transactions and use of confidential information would damage our reputation and brands, and substantially harm our business and result of operations.

If we are unable to adequately control the costs associated with operating our business, our results of operations will suffer.

The primary costs in operating our business are related to producing and shipping products, acquiring customers, compensating our personnel, acquiring equipment and technology, and leasing facilities. Controlling our business costs is challenging because many of the factors that impact these costs are beyond our control. For example, the costs to produce prints, such as the costs of photographic print paper, could increase due to a shortage of silver or an increase in worldwide energy prices. In addition, we may become subject to increased costs by the third-party shippers that deliver our products to our customers, and we may be unable to pass along any increases in shipping costs to our customers. The costs of online advertising and keyword search could also increase significantly due to increased competition, which would increase our customer acquisition costs. If we are unable to keep the costs associated with operating our business aligned with the level of revenues that we generate, our results of operations would be adversely affected.

If the third-party vendors who we depend upon to produce many of our products or those that deliver our product experience delays or interruptions in service, our customer experience will suffer, which would substantially harm our business, reputation and results of operations.

Our ability to provide a high-quality customer experience depends, in large part, on external factors over which we may have little or no control, including the reliability and performance of our suppliers, third-party product providers and shipping partners. For example, some of our products, such as select photo-based merchandise, are produced and shipped to customers by our third-party vendors, and we rely on these vendors to properly inspect and ship these products. In addition, we rely on third-party shippers, including the U.S. Postal Service and UPS to deliver our products to customers. Strikes, furloughs, reduced operations, increased shipping delays particularly during the holiday shopping season, or other service interruptions affecting these shippers could impair our ability to deliver merchandise on a timely basis. Our failure to provide customers with high-quality products in a timely manner for any reason could substantially harm our reputation and our efforts to develop trusted brands, which would substantially harm our business and results of operations.

We may have difficulty managing our growth and expanding our operations successfully.

We have website operations, offices and customer support centers in Redwood City, California, Santa Clara, California, and Tempe, Arizona and production facilities in Fort Mill, South Carolina; Shakopee, Minnesota and a new facility in Tempe, Arizona which became operational in the second quarter of 2015. Our growth has placed, and will continue to place, a strain on our administrative and operational infrastructure. Our ability to manage our operations and growth will require us to continue to refine our operational, financial and management controls, human resource policies and reporting systems.

If we are unable to manage future expansion, we may not be able to implement improvements to our controls, policies and systems in an efficient or timely manner and may discover deficiencies in existing systems and controls. Our ability to provide a high-quality customer experience could be compromised, which would damage our reputation and brands and substantially harm our business and results of operations.

In order to be successful, we must attract, engage, retain and integrate key employees and have adequate succession plans in place, and failure to do so could have an adverse effect on our ability to manage our business.

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Our success depends, in large part, on our ability to identify, hire integrate, retain and motivate qualified executives and other key employees throughout all areas of our business. Identifying, developing internally or hiring externally, training and retaining highly-skilled senior management, technical, marketing and production personnel are critical to our future, and competition for experienced employees can be intense. Competition for qualified personnel is particularly intense in the San Francisco Bay Area, where our headquarters are located. We may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing operational and managerial requirements, or we may be required to pay increased compensation in order to do so. Failure to successfully hire executives and key employees or the loss of any executives and key employees could have a significant impact on our operations. Further, a lack of management continuity could result in operational, technological, and administrative inefficiencies and added costs, which could adversely impact our results of operations and stock price and may make recruiting for future management positions more difficult. Changes in key management positions may temporarily affect our financial performance and results of operations as new management becomes familiar with our business.

Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees and senior executives could hinder our strategic planning and execution. We hired a new Chief Financial Officer in October 2015. On December 1, 2015, we announced that Jeffrey Housenbold, our President, Chief Executive Officer and member of our Board, intends to step down from his roles to pursue other opportunities effective February 2016. Also in December 2015, Daniel McCormick, our Senior Vice President and Chief Operating Officer, notified us of his intent to resign effective February 19, 2016. We currently have not hired a replacement Senior Vice President and Chief Operating Officer. Our search process, which is being led by the Board, to identify a candidate for a permanent Chief Executive Officer and President continues, and we continue to work with an executive search firm to assist with the process of identifying, evaluating and recruiting candidates. Our Chairman of the Board, Phil Marineau, will serve as the interim Chief Executive Officer. There are no assurances concerning the timing or outcome of our search for a new permanent President and Chief Executive Officer. Our ability to execute our business strategies, ensure a cohesive management team, and attract and retain key executives may be adversely affected by the uncertainty associated with the transition to a successor President and Chief Executive Officer.

In order to attract new personnel, we will need to grant inducement equity awards outside of our 2015 Equity Incentive Plan, which dilutes the ownership of our existing stockholders.

Since 2007, our board of directors has approved inducement equity awards outside of our 2006 Plan to select new employees upon hire and in connection with mergers and acquisitions without stockholder approval in accordance with NASDAQ Listing Rule 5635(c) for an aggregate of 2,216,061 shares of our common stock. In December 2015, we replaced the 2006 Plan with our 2015 Plan. We expect to continue making inducement equity awards outside of the 2015 Plan as we did with the 2006 Plan. The use of inducement equity awards may dilute the equity interest of our stockholders, which could in turn adversely affect prevailing market prices for our common stock.

In addition, we may issue equity securities to complete an acquisition, which would dilute our existing stockholders' ownership, perhaps significantly depending on the terms of such acquisitions and could adversely affect the price of our common stock. To finance any future acquisitions, it may also be necessary for us to raise additional funds through public or private debt and equity financings. Additional funds may not be available on terms that are favorable to us, and, in the case of equity financings, would result in dilution to our stockholders. Also, the value of our stock may be insufficient to attract acquisition candidates.

If we are unable to acquire customers in a cost-effective manner, or if we were to become subject to e-mail blacklisting, traffic to our websites would be reduced and our business and results of operations would be harmed.

Our success depends on our ability to attract customers in a cost-effective manner. We rely on a variety of methods to bring visitors to our websites and promote our products, including paying fees to third parties who drive new customers to our websites, purchasing search results from online search engines, e-mail and direct mail marketing campaigns. We pay providers of online services, search engines, social media, advertising networks, directories and other websites and e-commerce businesses to provide content, advertising/media and other links that direct customers to our websites. We also use e-mail and direct mail to attract customers, and we offer substantial pricing discounts and or free products to encourage repeat purchases and trial orders. Our methods of attracting customers, including acquiring customer lists from third parties can involve substantial costs, regardless of whether we acquire new customers as a result of such purchases. Even if we are successful in acquiring and retaining customers, the cost involved in these efforts impacts our results of operations. Customer lists are typically recorded as intangible assets and may be subject to impairment charges if the fair value of that list exceeds its carrying value. These potential impairment charges could harm our results from operations. If we are unable to enhance or maintain the methods we use to reach consumers, if the costs of acquiring customers using these methods significantly increase, or if we are unable to develop new cost-effective methods to obtain customers, our ability to attract new customers would be harmed, traffic to our websites may be reduced and our business and results of operations would be harmed.

In addition, various private entities attempt to regulate the use of e-mail for commercial solicitation. These entities often advocate standards of conduct or practice that significantly exceed current legal requirements and classify certain e-mail solicitations that comply with current legal requirements as unsolicited bulk e-mails, or “spam.” Some of these entities maintain blacklists of companies and individuals, and the websites, Internet service providers and Internet protocol addresses associated with those entities or individuals that do not adhere to what the blacklisting entity believes are appropriate standards of conduct or practices for commercial e-mail solicitations. If a company’s Internet protocol addresses are listed by a blacklisting entity, e-mails sent from those addresses may be blocked if they are sent to any Internet domain or Internet address that subscribes to the blacklisting entity’s service or purchases its blacklist. From time to time we are blacklisted, sometimes without our knowledge, which could impair our ability to market our products and services, communicate with our customers and otherwise operate our business. In addition, we have noted that unauthorized “spammers” utilize our domain name to solicit spam, which increases the frequency and likelihood that we may be blacklisted.

Our business and financial performance could be adversely affected by changes in search engine algorithms and dynamics, or search engine disintermediation.

We rely on Internet search engines such as Google, Yahoo! and Bing, including through the purchase of keywords related to photo-based products, to generate traffic to our websites. We obtain a significant amount of traffic via search engines and, therefore, utilize techniques such as search engine optimization and search engine marketing to improve our placement in relevant search queries. Search engines, including Google, Yahoo! and Bing, frequently update and change the logic that determines the placement and display of results of a user's search, such that the purchased or algorithmic placement of links to our websites can be negatively affected. Moreover, a search engine could, for competitive or other purposes, alter its search algorithms or results causing our websites to place lower in search query results. If a major search engine changes its algorithms in a manner that negatively affects our paid or unpaid search ranking, or if competitive dynamics impact the effectiveness of search engine optimization or search engine marketing in a negative manner, our business and financial performance would be adversely affected, potentially to a material extent.

We may not succeed in promoting and strengthening our brands, which would prevent us from acquiring new customers and increasing net revenues.

A component of our business strategy is the continued promotion and strengthening of the Shutterfly, Tiny Prints, Wedding Paper Divas, BorrowLenses, MyPublisher, Groovebook, and ThisLife brands. Due to the competitive nature of the digital photography products and services markets, if we are unable to successfully promote our brands, we may fail to attract new customers, increase the engagement of existing customers with our brands or substantially increase our net revenues. Customer awareness and the perceived value of our brands will depend largely on the success of our marketing efforts and our ability to provide a consistent, high-quality customer experience. To promote our brands, we have incurred, and will continue to incur, substantial expense related to advertising and other marketing efforts. The failure of our brand promotion activities could adversely affect our ability to attract new customers and maintain customer relationships, which would substantially harm our business and results of operations.

If we are unable to develop, market and sell new products and services that address additional market opportunities, our results of operations may suffer. In addition, we may need to expand beyond our current customer demographic to grow our business.

Although earlier in our history we have focused our business on consumer markets for silver halide prints, we have consistently evolved and broadened our offering to include other photo-based products, such as photo books, stationary cards, calendars, and photo merchandise such as mugs and magnets. We continually evaluate the demand for new products and services and the need to address trends in consumer demand and opportunities in the marketplace. For example, we have expanded in recent years into home decor, including wall art, ornaments and pillows. In 2014, we began to offer online photography and video equipment rentals through the BorrowLenses brand. In the future, we may need to address additional markets and expand our customer demographic to grow our business. Our efforts to expand our existing services, create new products and services, address new market segments or develop a significantly broader customer base may not be successful. Any failure to address additional market opportunities could result in loss of market share, which would harm our business, financial condition and results of operations.

We may undertake acquisitions to expand our business, which may pose risks to our business and dilute the ownership of our existing stockholders.

A key component of our business strategy includes strengthening our competitive position and refining the customer experience on our websites and mobile applications through internal development. However, from time to time, we may selectively pursue

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acquisitions of complementary businesses, such as our 2014 acquisition of selected assets of Dot Copy, Inc. ("Groovebook"), our 2013 acquisitions of BorrowLenses LLC, R&R Images, Inc. and MyPublisher, Inc. The identification of suitable acquisition candidates can be time-consuming and expensive, and we may not be able to successfully complete identified acquisitions. Furthermore, even if we successfully complete an acquisition, we may not achieve the anticipated benefits and synergies we expect due to a number of factors including the loss of management focus on and the diversion of resources from existing businesses; difficulty retaining key personnel of the acquired company; cultural challenges associated with integrating employees from an acquired company into our organization; difficulty integrating acquired technologies into our existing systems; entry into a business or market with which we have historically had little experience; difficulty integrating data systems; the need to implement or remediate the controls, procedures or policies of the acquired company; and increased risk of litigation. Failure to achieve the anticipated benefits of such acquisitions or the incurrence of debt, contingent liabilities, amortization expenses, or write-offs of goodwill in connection with such acquisitions could harm our operating results.

If the facility where our computer and communications hardware is located fails or if any of our production facilities fail, our business and results of operations would be harmed.

Our ability to successfully receive and fulfill orders and to provide high-quality customer service depends in part on the efficient and uninterrupted operation of our computer and communications systems. The computer hardware necessary to operate our website is in Las Vegas, Nevada. We also have computer hardware located in our production facilities in Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona. Our systems and operations could suffer damage or interruption from human error, fire, flood, power loss, insufficient power availability, telecommunications failure, break-ins, terrorist attacks, acts of war and similar events. In addition, our headquarters are located near a major fault line increasing our susceptibility to the risk that an earthquake could significantly harm our operations. We maintain business interruption insurance; however, this insurance may be insufficient to compensate us for losses that may occur, particularly from interruption due to an earthquake which is not covered under our current policy. We do not presently have redundant systems in multiple locations. In addition, the impact of any of these disasters on our business may be exacerbated by the fact that we are still in the process of developing our formal disaster recovery plan and we do not have a final plan in place.

We currently depend on third party suppliers for our photographic print paper, printing machines and other supplies, which expose us to risks if these suppliers fail to perform under our agreements with them.

We purchase photo-based and other product supplies from third parties. These parties could increase their prices, reallocate supply to others, including our competitors, or choose to terminate their relationship with us. If one of these third parties chooses not to renew their agreements or fails to perform in accordance with the terms of their agreements and we are not able to secure supplies and services from a different source in a timely manner, we could fail to meet customer expectations, which could damage our reputation and harm our business. This competition may influence their willingness to provide us with additional products or services. If we were required to switch vendors of machines for photo-based or other products, we may incur delays and incremental costs, which could harm our operating results.

We currently outsource some of our off-line and on-line marketing, and some of our customer service activities to third parties, which exposes us to risks if these parties fail to perform under our agreements with them.

We currently outsource some of our off-line and on-line marketing, and some of our customer service activities to third parties. If these parties fail to perform in accordance with the terms of our agreements and if we are unable to secure another outsource partner in a timely manner, we would likely fail to meet customer expectations, which could result in negative publicity, damage our reputation and brands and harm our business and results of operations. In the fourth quarter of 2015, a third party customer service provider experienced a disruption that affected our operations during peak times.

Changes in regulations or customer concerns regarding privacy and protection of customer data could harm our business, damage our reputation and result in a loss of customers.

Federal, state and international laws and regulations may govern the collection, use, sharing and security of data that we receive from our customers. In addition, we have and post on our websites our own privacy policies and practices concerning the collection, use and disclosure of customer data. Any failure, or perceived failure, by us to comply with our posted privacy policies or with any data-related consent orders, U.S. Federal Trade Commission requirements or other federal, state or international privacy-related laws and regulations could result in proceedings or actions against us by governmental entities or others, which could potentially harm our business. Further, failure or perceived failure to comply with our policies or applicable requirements related to the collection, use or security of personal information or other privacy-related matters could damage our reputation and result in a loss of customers.

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Failure to adequately protect our intellectual property could substantially harm our business and results of operations.

We rely on a combination of patent, trademark, trade secret and copyright law and contractual restrictions to protect our intellectual property. These protective measures afford only limited protection. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our website features and functionalities or to obtain and use information that we consider proprietary, such as the technology used to operate our websites, our production operations and our trademarks.

As of December 31, 2015, Shutterfly had 88 patents issued, and had more than 30 patent applications pending in the United States. We intend to pursue corresponding patent coverage in other countries to the extent we believe such coverage is appropriate and cost efficient. We cannot ensure that any of our pending applications will be granted. In addition, third parties have in the past and could in the future bring infringement, invalidity, co-inventorship or similar claims with respect to any of our currently issued patents or any patents that may be issued to us in the future. Any such claims, whether or not successful, could be extremely costly to defend, divert management’s time and attention, damage our reputation and brands and substantially harm our business and results of operations.

Our primary brands are “Shutterfly,” “Tiny Prints,” “Wedding Paper Divas,” and “BorrowLenses.” We hold applications and/or registrations for the Shutterfly, Tiny Prints, Wedding Paper Divas, BorrowLenses, Groovebook, MyPublisher, and ThisLife trademarks in our major markets of the United States and Canada as well as in the European Community. Our marks are critical components of our marketing programs. If we lose the ability to use these marks in any particular market, we could be forced to either incur significant additional marketing expenses within that market, or elect not to sell products in that market.

From time to time, third parties have adopted names similar to ours, applied to register trademarks similar to ours, and we believe have infringed or misappropriated our intellectual property rights and impeded our ability to build brand identity, possibly leading to customer confusion. In addition, we have been and may continue to be subject to potential trade name or trademark infringement claims brought by owners of marks that are similar to Shutterfly, Tiny Prints, Wedding Paper Divas, BorrowLenses, ThisLife or one of our other marks.

We respond on a case-by-case basis and where appropriate may send cease and desist letters or commence opposition actions and litigation. However, we cannot ensure that the steps we have taken to protect our intellectual property rights are adequate, that our intellectual property rights can be successfully defended and asserted in the future or that third parties will not infringe upon or misappropriate any such rights. In addition, our trademark rights and related registrations may be challenged in the future and could be canceled or narrowed. Failure to protect our trademark rights could prevent us in the future from challenging third parties who use names and logos similar to our trademarks, which may in turn cause consumer confusion or negatively affect consumers' perception of our brands, products, and services. Any claims or consumer confusion related to our marks could damage our reputation and brands and substantially harm our business and results of operations.

If we become involved in intellectual property litigation or other proceedings related to a determination of rights, we could incur substantial costs, expenses or liability, lose our exclusive rights or be required to stop certain of our business activities.

From time to time, we have received, and likely will continue to receive, communications from third parties inviting us to license their patents or accusing us of infringement. There can be no assurance that a third party will not take further action, such as filing a patent infringement lawsuit, including a request for injunctive relief to bar the manufacture and sale of our products and services in the United States or elsewhere. We may also choose to defend ourselves by initiating litigation or administrative proceedings to clarify or seek a declaration of our rights.

Additionally, from time to time, we have to defend against infringement of our intellectual property by bringing suit against other parties. As competition in our market grows, the possibility of patent infringement claims against us or litigation we will initiate increases.

The cost to us of any litigation or other proceeding relating to intellectual property rights, whether or not initiated by us and even if resolved in our favor, could be substantial, and the litigation would divert our management's efforts from growing our business. Some of our competitors may be able to sustain the costs of complex intellectual property litigation more effectively than we can because they have substantially greater resources. Uncertainties resulting from the initiation and continuation of any litigation could limit our ability to continue our operations.

Alternatively, we may be required to, or decide to, enter into a license with a third party. Any future license required under any other party's patents may not be made available on commercially acceptable terms, if at all. In addition, such licenses are likely to be non-exclusive and, therefore, our competitors may have access to the same technology licensed to us. If we fail to obtain a required license and are unable to design around a patent, we may be unable to effectively conduct certain of our business activities, which could limit our ability to generate revenues and harm our results of operations and possibly prevent us from generating revenues sufficient to sustain our operations.

Various governmental legal proceedings, investigations or audits may adversely affect our business and financial performance.

We may be subject to investigations or audits by governmental authorities and regulatory agencies, which can occur in the ordinary course of business or which can result from increased scrutiny from a particular agency towards an industry, country or practice. The resolution of such legal proceedings, investigations or audits could require us to pay substantial amounts of money or take actions that adversely affect our operations. In addition, defending against these claims may involve significant time and expense. Given the visibility of our brands, we may regularly be involved in legal proceedings, government investigations or audits that could adversely affect our business and financial performance.

Our effective tax rate may be subject to fluctuation from federal and state audits, and stock-based compensation activity.

Tax audits by taxing agencies for the open tax years could lead to fluctuations in our effective tax rate because the taxing authority may disagree with certain assumptions we have made regarding appropriate credits and deductions in filing our tax returns.

Our effective tax rate is subject to fluctuations under current tax regulations as a result of stock-based compensation activity. This activity includes items such as shortfalls associated with the vesting of restricted stock units and restricted stock awards, disqualifying dispositions when employees exercise and sell their incentive stock options within a two year period, and cancellation of vested non-qualified stock options.

Government regulation of the Internet and e-commerce is evolving, and unfavorable changes or failure by us to comply with these regulations could substantially harm our business and results of operations.

We are subject to general business regulations and laws as well as regulations and laws specifically governing the Internet and e-commerce. Existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, restrictions on imports and exports, customs, tariffs, user privacy, data protection, rights of publicity and rights of privacy, pricing, content, copyrights, distribution, electronic contracts and other communications, consumer protection, the provision of online payment services, broadband residential Internet access and the characteristics and quality of products and services. It is not clear how existing laws governing issues such as property use and ownership, sales and other taxes, fraud, libel and personal privacy and the rights of publicity apply to the Internet and e-commerce as the vast majority of these laws were adopted prior to the advent of the Internet and do not contemplate or address the unique issues raised by the Internet or e-commerce. Those laws that do reference the Internet continue to be interpreted by the courts and their applicability and reach are therefore uncertain. For example, and without limitation:

- The Digital Millennium Copyright Act ("DMCA") is intended, in part, to limit the liability of eligible online service providers for including (or for listing or linking to third-party websites that include) materials that infringe copyrights or other rights of others. Portions of the Communications Decency Act ("CDA") are intended to provide statutory protections to online service providers who distribute third-party content. We rely on the protections provided by both the DMCA and CDA in conducting our business. Any changes in these laws or judicial interpretations narrowing their protections will subject us to greater risk of liability and may increase our costs of compliance with these regulations or limit our ability to operate certain lines of business.

- The Children’s Online Protection Act and the Children’s Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

- The Credit Card Accountability, Responsibility and Disclosure Act (“CARD Act”) is intended to protect consumers from unfair credit card billing practices and adds new regulations on the use of gift cards, limiting our ability to expire them. Several states are attempting to pass new laws regulating the use of gift cards and amending state escheatment laws to try to pass new laws regulating the use of gift cards and amending state escheatment laws to try and obtain unused gift card balances.

- The Restore Online Shoppers’ Confidence Act (“ROSCA”) prohibits and prevents Internet-based post-transaction third party sales and imposes specific requirements on negative option features.

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- The Illinois Biometric Information Privacy Act (“IBIPA”) regulates the collection, use, safeguarding, and storage of "biometric identifiers" or "biometric information" by private entities. On June 17, 2015, Brian Norberg on behalf of himself and all others similarly situated, brought a complaint against us in the United States District Court for the Northern District of Illinois. The suit claims Shutterfly violated the IBIPA by extracting his and others biometric identifiers from photographs. We strenuously deny this claim. On December 29, 2015, the court rejected our motion to dismiss and allowed the case to proceed; however, we continue to strenuously deny this claim.

The costs of compliance with these and other regulations may increase in the future as a result of changes in the regulations or the interpretation of them. Further, any failures on our part to comply with these regulations may subject us to significant liabilities. Those current and future laws and regulations or unfavorable resolution of these issues may substantially harm our business and results of operations.

Legislation regarding copyright protection or content review could impose complex and costly constraints on our business model.

Because of our focus on automation and high volumes, our operations do not involve, for the vast majority of our sales, any human-based review of content. Although our websites' terms of use specifically require customers to represent that they have the right and authority to provide and submit to us and to reproduce the content they provide and submit and that the content is in full compliance with all relevant laws and regulations and does not infringe on any third party intellectual property or other proprietary rights or rights of publicity or rights of privacy, we do not have the ability to determine the accuracy of these representations on a case-by-case basis. There is a risk that a customer may supply an image or other content that is the property of another party used without permission, that infringes the copyright or trademark of another party or another party's right of privacy or right of publicity, or that would be considered to be defamatory, pornographic, hateful, racist, scandalous, obscene or otherwise offensive, objectionable or illegal under the laws or court decisions of the jurisdiction where that customer lives. There is, therefore, a risk that customers may intentionally or inadvertently order and receive products from us that are in violation of the rights of another party or a law or regulation of a particular jurisdiction. If we should become legally obligated in the future to perform manual screening and review for all orders destined for a jurisdiction, we will encounter increased production costs or may cease accepting orders for shipment to that jurisdiction which could substantially harm our business and results of operations.

Our practice of offering free products and services could be subject to judicial or regulatory challenge.

We regularly offer free products or free shipping as an inducement for customers to try our products. Although we believe that we conspicuously and clearly communicate all details and conditions of these offers, for example, that customers are required to pay shipping, handling and/or processing charges to take advantage of the free product offer, we may have been subject to claims from individuals or governmental regulators that our free offers are misleading or do not comply with applicable legislation. These claims may be expensive to defend and could divert management’s time and attention. If we become subject to such claims in the future, or are required or elect to curtail or eliminate our use of free offers, our business and results of operations may be harmed.

International expansion would require management attention and resources and may be unsuccessful, which could harm our future business development and existing domestic operations.

To date, we have conducted limited international operations, but may in the future decide to expand into international markets in order to grow our business. These expansion plans will require significant management attention and resources and may be unsuccessful. We have limited experience adapting our products to conform to local cultures, standards and policies. We may have to compete with established local or reg `` ional companies which understand the local market better than we do. In addition, to achieve satisfactory performance for consumers in international locations it may be necessary to locate physical facilities, such as production facilities, in the foreign market. We do not have experience establishing, acquiring or operating such facilities overseas. We may not be successful in expanding into any international markets or in generating revenues from foreign operations. In addition, different privacy, censorship and liability standards and regulations and different intellectual property laws in foreign countries may result in additional expenses, diversion of resources, including the attention of our management team.

The success of our business depends on our ability to adapt to the continued evolution of digital photography.

The digital photography market is rapidly evolving, characterized by changing technologies, intense price competition, additional competitors, evolving industry standards, frequent new service and platform announcements and changing consumer demands and behaviors. To the extent that consumer adoption of digital photography does not continue to grow as expected, our revenue growth would likely suffer. Moreover, we face significant risks that, if the market for digital photography evolves in ways that we are not able to address due to changing technologies or consumer behaviors, pricing pressures, or otherwise, our current products and services may become less attractive, which would result in the loss of customers, as well as lower net revenues and/or increased expenses.

Purchasers of digital photography products and services may not choose to shop or rent online, which would harm our net revenues and results of operations.

The online market for digital photography products and services, including photographic and video equipment rentals, is less developed than the online market for other consumer products. If this market does not gain widespread acceptance, our business may suffer. Our success will depend in part on our ability to attract customers who historically have used traditional retail photography services or who have produced photographs and other products using self-service alternatives, such as printing at home. Furthermore, we may have to incur significantly higher and more sustained advertising and promotional expenditures or reduce the prices of our products and services in order to attract additional online consumers to our websites and convert them into purchasing customers. Specific factors that could prevent prospective customers from purchasing from us include:

- the inability to physically handle and examine product samples;
- delivery time associated with Internet orders;
- costs associated with shipping and handling;
- concerns about the security of online transactions and the privacy of personal information;
- delayed shipments or shipments of incorrect or damaged products; and
- inconvenience associated with returning or exchanging purchased items.

If purchasers of digital photography products and services do not choose to shop or rent online, our net revenues and results of operations would be harmed.

If our internal controls are not effective or our third-party software systems that we use to assist us in the calculation and reporting of financial data have errors, there may be errors in our financial information that could require a restatement or delay our SEC filings, and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

It is possible that we may discover significant deficiencies or material weaknesses in our internal control over financial reporting in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could cause us to fail to meet our periodic reporting obligations, or result in material misstatements in our financial information. We use numerous third party licensed software packages, most notably our equity software and our Enterprise resource planning software, which are complex and fully integrated into our financial reporting. Such third party software may contain errors that we may not identify in a timely manner. If those errors are not identified and addressed timely, our financial reporting may not be in compliance with generally accepted accounting principles. Any such delays, errors or restatements could cause investors to lose confidence in our reported financial information and lead to a decline in our stock price.

Maintaining and improving our financial controls and the requirements of being a public company may strain our resources, divert management's attention and affect our ability to attract and retain qualified board members.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002 and the rules and regulations of The NASDAQ Stock Market. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 contains various provisions applicable to the corporate governance functions of public companies. Additional or new regulatory requirements may be adopted in the future. The requirements of existing and potential future rules and regulations will likely continue to increase our legal, accounting and financial compliance costs, make some activities more difficult, time-consuming or costly and may also place undue strain on our personnel, systems and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and effective internal control over financial reporting. Significant resources and management oversight are required to design, document, test, implement and monitor internal control over relevant processes and to remediate any deficiencies. As a result, management's attention may be diverted from other business concerns, which could harm our business, financial condition and results of operations. These efforts also involve substantial accounting related costs. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on The NASDAQ Global Select Market.

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Under the Sarbanes-Oxley Act and the rules and regulations of The NASDAQ Stock Market, we are required to maintain a board of directors with a majority of independent directors. These rules and regulations may make it more difficult and more expensive for us to maintain directors' and officers' liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate directors' and officers' insurance, our ability to recruit and retain qualified directors and officers, especially those directors who may be considered independent for purposes of NASDAQ rules, will be significantly curtailed.

Risks Related to Our Common Stock

Our stock price may be volatile or may decline regardless of our operating performance.

The market price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control. In particular, the stock market as a whole recently has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to those companies' operating performance. Factors that could cause our stock price to fluctuate include:

- slow economic growth, and market conditions or trends in our industry or the macro-economy as a whole;
- worldwide economic and market trends and conditions;
- price and volume fluctuations in the overall stock market;
- changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular;
- the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections;
- the loss of key personnel;
- changes in financial estimates by any securities analysts who follow our company, our failure to meet these estimates or failure of those analysts to initiate or maintain coverage of our stock;
- ratings downgrades by any securities analysts who follow our company;
- business disruptions and costs related to shareholder activism;
- the public's response to our press releases or other public announcements, including our filings with the SEC;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures, acquisitions or capital commitments;
- introduction of technologies or product enhancements that reduce the need for our products;
- lawsuits threatened or filed against us;
- future sales of our common stock by our executive officers, directors and significant stockholders; and
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

Provisions of our restated certificate of incorporation and restated bylaws and Delaware law may deter third parties from acquiring us.

Our restated certificate of incorporation and restated bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

- our board is classified into three classes of directors, each with staggered three-year terms;
- only our chairman, our chief executive officer, our president, or a majority of our board of directors is authorized to call a special meeting of stockholders;
- our stockholders may take action only at a meeting of stockholders and not by written consent;

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- vacancies on our board of directors may be filled only by our board of directors and not by stockholders;
- our certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for stockholders to elect directors of their choosing and to cause us to take other corporate actions they desire.

In addition, we are subject to Section 203 of the Delaware General Corporation Law, which, subject to some exceptions, prohibits "business combinations" between a Delaware corporation and an "interested stockholder," which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock, for a three-year period following the date that the stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control that our stockholders might consider to be in their best interests.

Our stock repurchase program could affect the price of our common stock and increase volatility and may be suspended or terminated at any time, which may result in a decrease in the trading price of our common stock.

In February of 2015, our board of directors approved an increase to the share repurchase program of up to $300.0 million in addition to amounts remaining. Through December 31, 2015, we have repurchased $310.7 million in stock under our total authorized amount of $406.0 million. The timing and actual number of shares repurchased will depend on a variety of factors including the timing of open trading windows, price, corporate and regulatory requirements, an assessment by management and our board of directors of cash availability and other market conditions. The stock repurchase program may be suspended or discontinued at any time without prior notice. Repurchases pursuant to our stock repurchase program could affect the price of our common stock and increase its volatility. The existence of our stock repurchase program could also cause the price of our common stock to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our common stock. Additionally, repurchases under our stock repurchase program will diminish our cash reserves, which could impact our ability to further develop our technology, access and/or retrofit additional facilities and service our indebtedness. There can be no assurance that any stock repurchases will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased such shares. Any failure to repurchase shares after we have announced our intention to do so may negatively impact our reputation and investor confidence in us and may negatively impact our stock price. Although our stock repurchase program is intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the program’s effectiveness.

We do not intend to pay dividends on our common stock for the foreseeable future.

We have never declared or paid cash dividends on our common stock. In addition, we must comply with the covenants in our credit facilities if we want to pay cash dividends. We currently intend to retain our future earnings, if any, to finance the further development and expansion of our business and do not intend to pay cash dividends in the foreseeable future. Any future determination to pay dividends will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, capital requirements, restrictions contained in current or future financing instruments and such other factors as our board of directors deems relevant.

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Risks Related to Our 0.25% Senior Convertible Senior Notes Due in 2018 (the "Notes")

Although the notes are referred to as convertible senior notes, they are effectively subordinated to any of our secured debt and any liabilities of our subsidiaries.

The notes will rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the notes; equal in right of payment to any of our liabilities that are not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of our subsidiaries. In the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior in right of payment to the notes will be available to pay obligations on the notes only after the secured debt has been repaid in full from these assets, and the assets of our subsidiaries will be available to pay obligations on the notes only after all claims senior to the notes (including any amounts drawn under our credit facility) have been repaid in full. There may not be sufficient assets remaining to pay amounts due on any or all of the notes then outstanding. The indenture governing the notes does not prohibit us from incurring additional senior debt or secured debt, nor does it prohibit any of our subsidiaries from incurring additional liabilities.

Recent and future regulatory actions and other events may adversely affect the trading price and liquidity of the notes.

We expect that many investors in, and potential purchasers of, the notes will employ, or seek to employ, a convertible arbitrage strategy with respect to the notes. Investors would typically implement such a strategy by selling short the common stock underlying the notes and dynamically adjusting their short position while continuing to hold the notes. Investors may also implement this type of strategy by entering into swaps on our common stock in lieu of or in addition to short selling the common stock. The Securities and Exchange Commission ("SEC") and other regulatory and self-regulatory authorities have implemented various rules and taken certain actions, and may in the future adopt additional rules and take other actions, that may impact those engaging in short selling activity involving equity securities (including our common stock). Such rules and actions include Rule 201 of SEC Regulation SHO, the adoption by the Financial Industry Regulatory Authority, Inc. and the national securities exchanges of a “Limit Up-Limit Down” program, the imposition of market-wide circuit breakers that halt trading of securities for certain periods following specific market declines, and the implementation of certain regulatory reforms required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Any governmental or regulatory action that restricts the ability of investors in, or potential purchasers of, the notes to effect short sales of our common stock or enter into swaps on our common stock could adversely affect the trading price and the liquidity of the notes.

In addition, if investors and potential purchasers seeking to employ a convertible arbitrage strategy are unable to borrow or enter into swaps on our common stock, in each case on commercially reasonable terms, the trading price and liquidity of the notes may be adversely affected.

Volatility in the market price and trading volume of our common stock could adversely impact the trading price of the notes.

The stock market in recent years has experienced significant price and volume fluctuations that have often been unrelated to the operating performance of companies. The market price of our common stock could fluctuate significantly for many reasons, including in response to the risks described in this section, or for reasons unrelated to our operations, such as reports by industry analysts, investor perceptions or negative announcements by our customers, competitors or suppliers regarding their own performance, as well as industry conditions and general financial, economic and political instability. A decrease in the market price of our common stock would likely adversely impact the trading price of the notes. The price of our common stock could also be affected by possible sales of our common stock by investors who view the notes as a more attractive means of equity participation in us and by hedging or arbitrage trading activity that we expect to develop involving our common stock. This trading activity could, in turn, affect the trading prices of the notes.

We may still incur substantially more debt or take other actions which would intensify the risks discussed above.

We and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our debt instruments, some of which may be secured debt. We will not be restricted under the terms of the indenture governing the notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the notes that could have the effect of diminishing our ability to make payments on the notes when due. Our existing credit facility restricts our ability to incur additional indebtedness, including secured indebtedness, but if the facility matures or is repaid, we may not be subject to such restrictions under the terms of any subsequent indebtedness.

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We may not have the ability to raise the funds necessary to settle conversions of our notes in cash or to repurchase the notes upon a fundamental change, and our current debt contains, and our future debt may contain, limitations on our ability to pay cash on conversion or repurchase the notes.

Holders of the notes have the right to require us to repurchase their notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, if any. In addition, upon conversion of the notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of notes surrendered therefor or notes being converted.

In addition, our ability to repurchase the notes and settle conversions in cash is limited by our credit facility and may be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to repurchase notes at a time when the repurchase is required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under the credit facility agreements governing our future indebtedness. Moreover, the occurrence of a fundamental change under the indenture would constitute an event of default under our credit facility. If the payment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the notes or to pay cash upon conversion of the notes.

The conditional conversion feature of the notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the notes is triggered, holders of notes will be entitled to convert the notes at any time during specified periods at their option. If one or more holders elect to convert their notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation in cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the notes, could have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, which we refer to as FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the notes to their face amount over the term of the notes. We will report lower net income in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the notes.

In addition, under certain circumstances, convertible debt instruments (such as the notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that any shares issuable upon conversion of the notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the notes, then our diluted earnings per share would be adversely affected.

Future sales of our common stock in the public market could lower the market price for our common stock and adversely impact the trading price of the notes.

In the future, we may sell additional shares of our common stock to raise capital. In addition, a substantial number of shares of our common stock is reserved for issuance upon the exercise of stock options, the vesting of restricted stock units and other equity awards pursuant to our employee benefit plans, upon conversion of the notes, and in relation to the convertible note hedge and warrant transactions entered into in connection with the pricing of the notes. We cannot predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the trading price of the notes and the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

Holders of notes will not be entitled to any rights with respect to our common stock, but they will be subject to all changes made with respect to them to the extent our conversion obligation includes shares of our common stock.

Holders of notes will not be entitled to any rights with respect to our common stock (including, without limitation, voting rights and rights to receive any dividends or other distributions on our common stock) prior to the conversion date relating to such notes (if we elect to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), but holders of notes will be subject to all changes affecting our common stock. For example, if an amendment is proposed to our certificate of incorporation or bylaws requiring stockholder approval and the record date for determining the stockholders of record entitled to vote on the amendment occurs prior to the conversion date related to a holder's conversion of its notes (if we have elected to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), such holder will not be entitled to vote on the amendment, although such holder will nevertheless be subject to any changes affecting our common stock.

The conditional conversion feature of the notes could result in holders receiving less than the value of our common stock into which the notes would otherwise be convertible.

Holders of notes may convert their notes only if specified conditions are met. If the specific conditions for conversion are not met, holders will not be able to convert their notes, and may not be able to receive the value of the cash, common stock or a combination of cash and common stock, as applicable, into which the notes would otherwise be convertible.

Upon conversion of the notes, holders may receive less valuable consideration than expected because the value of our common stock may decline after holders exercise their conversion rights but before we settle our conversion obligation.

Under the notes, a converting holder will be exposed to fluctuations in the value of our common stock during the period from the date such holder surrenders notes for conversion until the date we settle our conversion obligation. Upon conversion of the notes, we have the option to pay or deliver, as the case may be, cash, shares of our common stock, or a combination of cash and shares of our common stock. If we elect to satisfy our conversion obligation in cash or a combination of cash and shares of our common stock, the amount of consideration that holders will receive upon conversion of their notes will be determined by reference to the volume weighted average prices of our common stock for each trading day in a 30 trading-day observation period. Accordingly, if the price of our common stock decreases during such observation period, the amount and/or value of consideration holders receive will be adversely affected. In addition, if the market price of our common stock at the end of such period is below the average of the volume weighted average price of our common stock during such period, the value of any shares of our common stock that holders will receive in satisfaction of our conversion obligation will be less than the value used to determine the number of shares that holders will receive.

If we elect to satisfy our conversion obligation solely in shares of our common stock upon conversion of the notes, we will be required to deliver the shares of our common stock, together with cash for any fractional share, three business days after the relevant conversion date. Accordingly, if the price of our common stock decreases during this period, the value of the shares that holders receive will be adversely affected and would be less than the conversion value of the notes on the conversion date.

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The notes are not protected by restrictive covenants.

The indenture governing the notes does not contain any financial or operating covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. The indenture contains no covenants or other provisions to afford protection to holders of the notes in the event of a fundamental change or other corporate transaction involving us except under limited circumstances.

The increase in the conversion rate for notes converted in connection with a make-whole fundamental change may not adequately compensate holders for any lost value of their notes as a result of such transaction.

If a make-whole fundamental change occurs prior to the maturity date, under certain circumstances, we will increase the conversion rate by a number of additional shares of our common stock for notes converted in connection with such make-whole fundamental change. The increase in the conversion rate will be determined based on the date on which the specified corporate transaction becomes effective and the price paid (or deemed to be paid) per share of our common stock in such transaction. The increase in the conversion rate for notes converted in connection with a make-whole fundamental change may not adequately compensate holders for any lost value of their notes as a result of such transaction. Our obligation to increase the conversion rate for notes converted in connection with a make-whole fundamental change could be considered a penalty, in which case the enforceability thereof would be subject to general principles of reasonableness and equitable remedies.

The conversion rate of the notes may not be adjusted for all dilutive events.

The conversion rate of the notes is subject to adjustment for certain events, including, but not limited to, the issuance of certain stock dividends on our common stock, the issuance of certain rights or warrants, subdivisions, combinations, distributions of capital stock, indebtedness, or assets, cash dividends and certain issuer tender or exchange offers. However, the conversion rate will not be adjusted for other events, such as a third-party tender or exchange offer or an issuance of common stock for cash that may adversely affect the trading price of the notes or our common stock. An event that adversely affects the value of the notes may occur, and that event may not result in an adjustment to the conversion rate.

Provisions in the indenture for the notes may deter or prevent a business combination that may be favorable to holders of the notes.

If a fundamental change occurs prior to the maturity date of the notes, holders of the notes will have the right, at their option, to require us to repurchase all or a portion of their notes. In addition, if a make-whole fundamental change occurs prior to the maturity date of the notes, we will in some cases be required to increase the conversion rate for a holder that elects to convert its notes in connection with such fundamental change. Furthermore, the indenture for the notes prohibits us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the notes. These and other provisions in the indenture could deter or prevent a third party from acquiring us even when the acquisition may be favorable to holders of the notes.

Some significant restructuring transactions may not constitute a fundamental change, in which case we would not be obligated to offer to repurchase the notes.

Upon the occurrence of a fundamental change, holders have the right to require us to repurchase their notes. However, the fundamental change provisions will not afford protection to holders of notes in the event of other transactions that could adversely affect the notes. For example, transactions such as leveraged recapitalizations, refinancings, restructurings, or acquisitions initiated by us may not constitute a fundamental change requiring us to repurchase the notes. In the event of any such transaction, the holders would not have the right to require us to repurchase the notes, even though each of these transactions could increase the amount of our indebtedness, or otherwise adversely affect our capital structure or any credit ratings, thereby adversely affecting the holders of notes.

We have not registered the notes or the common stock issuable upon conversion, if any, which will limit holders' ability to resell them.

The notes and the shares of common stock issuable upon conversion of the notes, if any, have not been registered under the Securities Act of 1933, as amended, or the Securities Act, or any state securities laws. Unless the notes and any shares of common stock issuable upon conversion of the notes have been registered, they may not be transferred or resold except in a transaction exempt from or not subject to the registration requirements of the Securities Act and applicable state securities laws. We do not intend to file a registration statement for the resale of the notes and the common stock, if any, into which the notes are convertible.

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An active trading market may not develop for the notes.

Prior to our issuance of the notes, there had been no trading market for the notes. We do not intend to apply to list the notes on any securities exchange or to arrange for quotation on any automated dealer quotation system. The liquidity of the trading market in the notes, and the market price quoted for the notes, may be adversely affected by changes in the overall market for this type of security and by changes in our financial performance or prospects or in the prospects for companies in our industry generally. As a result, we cannot assure holders that an active trading market will develop for the notes. If an active trading market does not develop or is not maintained, the market price and liquidity of the notes may be adversely affected. In that case holders may not be able to sell their notes at a particular time or holders may not be able to sell their notes at a favorable price.

Any adverse rating of the notes may cause their trading price to fall.

We do not intend to seek a rating on the notes. However, if a rating service were to rate the notes and if such rating service were to lower its rating on the notes below the rating initially assigned to the notes or otherwise announces its intention to put the notes on credit watch, the trading price of the notes could decline.

Holders of the notes may be subject to tax if we make or fail to make certain adjustments to the conversion rate of the notes even though such holders do not receive a corresponding cash distribution.

The conversion rate of the notes will be adjusted in certain circumstances. Under Section 305(c) of the Internal Revenue Code of 1986, or the Code, adjustments (or failures to make adjustments) that have the effect of increasing the holders' proportionate interest in our assets or earnings may in some circumstances result in a deemed distribution to the holders. Certain of the conversion rate adjustments with respect to the notes (including, without limitation, adjustments in respect of taxable dividends to holders of our common stock) will result in deemed distributions to the holders of notes even though they have not received any cash or property as a result of such adjustments. In addition, an adjustment to the conversion rate in connection with a make-whole fundamental change may be treated as a deemed distribution. Any deemed distributions will be taxable as a dividend, return of capital, or capital gain. If holders are a “non-U.S. holder” under the Code any deemed dividend may be subject to U.S. withholding tax at a 30% rate or such lower rate as may be specified by an applicable tax treaty, which may be set off against subsequent payments on the notes (or in certain circumstances, on the common stock). Under proposed regulations relating to certain “dividend equivalent” payments, an adjustment to the conversion rate of the notes as a result of a dividend on our common stock may be subject to withholding tax at a different time or in a different amount than the withholding tax otherwise imposed on dividends and constructive dividends.

The convertible note hedge and warrant transactions may affect the value of the notes and our common stock.

In connection with the pricing of the notes, we entered into convertible note hedge transactions with Morgan Stanley & Co. International plc, Credit Suisse International, Citibank, N.A., and Bank of America, N.A., or the option counterparties. We also entered into warrant transactions with the option counterparties pursuant to which we will sell warrants for the purchase of our common stock. The convertible note hedge transactions are expected generally to reduce the potential dilution upon any conversion of notes and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of the notes. The warrant transactions could separately have a dilutive effect to the extent that the market price per share of our common stock exceeds the strike price of the warrants. However, subject to certain conditions, we may elect to settle the warrant transactions in cash.

The option counterparties and/or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock in secondary market transactions following the pricing of the notes and prior to the maturity of the notes (and are likely to do so during any observation period related to a conversion of notes or following any repurchase of notes by us on any fundamental change repurchase date or otherwise). This activity could also cause or avoid an increase or a decrease in the market price of our common stock or the notes, which could affect holders' ability to convert the notes and, to the extent the activity occurs during any observation period related to a conversion of notes, it could affect the amount and value of the consideration that holders will receive upon conversion of the notes.

In addition, if any such convertible note hedge and warrant transactions fail to become effective, the option counterparties may unwind their hedge positions with respect to our common stock, which could adversely affect the value of our common stock and the value of the notes. The potential effect, if any, of these transactions and activities on the market price of our common stock or the notes will depend in part on market conditions and cannot be ascertained at this time. Any of these activities could adversely affect the value of our common stock and the value of the notes (and as a result, the value of the consideration, the amount of cash and/or the number of shares, if any, that holders would receive upon the conversion of the notes) and, under certain

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circumstances, holders' ability to convert the notes. The convertible note hedge transactions and the warrant transactions are separate transactions (in each case entered into between us and the option counterparties), are not part of the terms of the notes and will not affect the holders' rights under the notes. Holders of the notes will not have any rights with respect to the convertible note hedge transactions or the warrant transactions.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the notes or our common stock. In addition, we do not make any representation that the option counterparties will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

We are subject to counterparty risk with respect to the convertible note hedge transactions.

The option counterparties are financial institutions, and we will be subject to the risk that any or all of them might default under the convertible note hedge transactions. Our exposure to the credit risk of the option counterparties will not be secured by any collateral. Recent global economic conditions have resulted in the actual or perceived failure or financial difficulties of many financial institutions. If an option counterparty becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings, with a claim equal to our exposure at that time under our transactions with that option counterparty. Our exposure will depend on many factors but, generally, an increase in our exposure will be correlated to an increase in the market price and in the volatility of our common stock. In addition, upon a default by an option counterparty, we may suffer adverse tax consequences and more dilution than we currently anticipate with respect to our common stock. We can provide no assurances as to the financial stability or viability of the option counterparties.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2. PROPERTIES.

The table below includes material property leases, including both operating and build-to-suit leases.

We believe that our existing facilities are adequate to meet our current needs.

Location	Principal Use	Square Footage	Lease Term
Redwood City, California (1)	Corporate headquarters	100,000	2017
Santa Clara, California (2)	Office space	53,700	2017
Fort Mill, South Carolina (3)	Manufacturing and customer service facility	300,000	2023
Elmsford, New York (4)	Office space	40,000	2023
Shakopee, Minnesota (5)	Manufacturing and customer service facility	217,000	2024
Tempe, Arizona (6)	Manufacturing and customer service facility	237,000	2025

(1) We have an option to extend the lease for two additional periods of three years each.
(2) We have an option to extend the lease for one additional period of three years.
(3) We have the option to expand the facility by an additional 100,000 square feet as well as an option to extend the lease for one additional period of five years.
(4) We have an option to extend the lease for two additional periods of five years each.
(5) We have an option to extend the lease for three additional periods of five years.
(6) This facility became operational during the second quarter of 2015. We have the option to expand the facility by an additional 91,000 square feet as well as an option to extend the lease for two additional periods of five years each.

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ITEM 3. LEGAL PROCEEDINGS

We are subject to the various legal proceedings and claims discussed below as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. Although adverse decisions (or settlements) may occur in one or more of these proceedings, it is not possible to estimate the possible loss or losses from each of these proceedings. The final resolution of these proceedings, individually or in the aggregate, is not expected to have a material adverse effect on our business, financial position or results of operations. Cases that previously were disclosed may no longer be described because of rulings in the case, settlements, changes in our business or other developments rendering them, in our judgment, no longer material to our business, financial position or results of operations. No material legal proceeding was terminated during the fourth quarter of 2015.

The State of Delaware v. Shutterfly, Inc.

On May 1, 2014, the State of Delaware filed a complaint against us for alleged violations of the Delaware False Claims and Reporting Act, 6 Del C. § 1203(b)(2). The complaint asserts that we failed to report and remit to Delaware cash equal to the balances on unused gift cards under the Delaware Escheats Law, 12 Del. C. § 1101 et seq. We believe the suit is without merit.

Norberg vs. Shutterfly, Inc. et. al

On June 17, 2015, Brian Norberg on behalf of himself and all others similarly situated, brought a complaint against us in the U.S. District Court for the Northern District of Illinois. The complaint asserts that we violated the Illinois Biometric Information Privacy Act (“IBIPA”) by extracting his and others biometric identifiers from photographs and seeks statutory damages and an injunction. On December 29, 2015, the court rejected our motion to dismiss and allowed the case to proceed, however we continue to strenuously deny this claim.

In all cases, at each reporting period, we evaluate whether or not a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses accounting for contingencies. In such cases, we accrue for the amount, or if a range, we accrue the low end of the range as a component of legal expense. We monitor developments in these legal matters that could affect the estimate we had previously accrued. There are no amounts accrued that we believe would be material to our financial position and results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

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PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Shutterfly’s common stock is traded on the NASDAQ Global Select Market under the symbol “SFLY.” As of February 11, 2016, there were approximately 77 stockholders of record, excluding stockholders whose shares were held in nominee or street name by brokers. We have never paid cash dividends on our capital stock and we do not anticipate paying any cash dividends in the foreseeable future.

The following table sets forth the high and low closing sales price per share for Shutterfly’s common stock for the periods indicated:

Year Ended December 31, 2014	High	Low
First Quarter	$54.56	$41.39
Second Quarter	$43.87	$36.78
Third Quarter	$51.01	$43.51
Fourth Quarter	$49.26	$39.44

Year Ended December 31, 2015	High	Low
First Quarter	$48.67	$39.97
Second Quarter	$48.70	$44.15
Third Quarter	$48.76	$35.59
Fourth Quarter	$46.67	$35.71

Issuer Purchases of Equity Securities

The following table provides information about our repurchase of shares of our common stock during the fourth quarter of the fiscal year ended December 31, 2015:

Period (1)	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased Under Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans Or Programs (in thousands) (2)
October 1, 2015 to October 31, 2015	409,368	$38.20	409,368	$124,642
November 1, 2015 to November 30, 2015	288,175	43.99	288,175	111,966
December 1, 2015 to December 31, 2015	370,439	45.06	370,439	95,275
Total	1,067,982	$42.14	1,067,982	$95,275

(1) All shares were purchased pursuant to the publicly announced share repurchase program described in footnote 2 below. Shares are reported in a period based on the settlement date of the applicable repurchase.

(2) On November 1, 2012, we announced a share repurchase program authorized by our Board of Directors and approved by our Audit Committee to repurchase up to $60 million of our common stock. On February 6, 2014, our Board of Directors approved an increase to the share repurchase program to allow for repurchases of up to an additional $100 million of shares in addition to any amounts repurchased as of the approval date. On February 9,

2015, our Board of Directors approved an increase to the share repurchase program to allow for repurchases of up to an additional $300 million of shares in addition to any amounts repurchased as of the approval date.

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ITEM 6. SELECTED FINANCIAL DATA.

The consolidated statements of operations data for the years ended December 31, 2015, 2014 and 2013 and the consolidated balance sheet data as of December 31, 2015 and 2014 have been derived from our audited consolidated financial statements included elsewhere in this annual report on Form 10-K. The consolidated statements of operations data for the years ended December 31, 2012 and 2011 and the consolidated balance sheet data as of December 31, 2013, 2012 and 2011 have been derived from our audited consolidated financial statements not included in this annual report on Form 10-K. The following selected consolidated financial data should be read in conjunction with our “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and consolidated financial statements and related notes to those statements included elsewhere in this annual report on Form 10-K.

	Year Ended December 31,				
	2015	2014	2013	2012	2011
	(In thousands, except per share amounts)				
Consolidated Operations Statement Data:					
Net revenues	$1,059,429	$921,580	$783,642	$640,624	$473,270
Cost of net revenues	528,078	452,720	369,593	294,857	219,542
Gross profit	531,351	468,860	414,049	345,767	253,728
Operating expenses:					
Technology and development	155,318	133,623	108,995	85,746	65,675
Sales and marketing	236,749	216,035	189,985	148,806	113,952
General and administrative	121,019	112,957	93,011	70,502	58,710
Total operating expenses	513,086	462,615	391,991	305,054	238,337
Income from operations	18,265	6,245	22,058	40,713	15,391
Interest expense	(20,998)	(16,732)	(9,446)	(597)	(64)
Interest and other income, net	744	508	308	42	35
Income/(loss) before income taxes	(1,989)	(9,979)	12,920	40,158	15,362
Benefit from/(provision for) income taxes	1,146	2,119	(3,635)	(17,160)	(1,314)
Net income/(loss)	$(843)	$(7,860)	$9,285	$22,998	$14,048
Net income/(loss) per share:					
Basic	$(0.02)	$(0.20)	$0.25	$0.64	$0.43
Diluted	$(0.02)	$(0.20)	$0.24	$0.61	$0.40
Weighted average shares:					
Basic	36,761	38,452	37,680	35,826	32,788
Diluted	36,761	38,452	39,493	37,432	35,007

The chart above includes the following stock-based compensation amounts:

	Year Ended December 31,				
	2015	2014	2013	2012	2011
	(In thousands)				
Cost of net revenues	$4,134	$3,657	$2,485	$1,696	$2,138
Technology and development	10,840	9,236	9,477	8,635	8,201
Sales and marketing	21,512	22,670	19,774	11,559	11,350
General and administration	23,972	26,199	21,792	15,432	12,181

The chart below includes selected data from our balance sheet:

	December 31, 2015	2014	2013	2012	2011
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents, and investments	$340,786	$475,337	$499,084	$245,088	$179,915
Property and equipment, net	281,779	241,742	155,727	92,667	54,123
Working capital	201,824	352,172	413,338	148,855	130,259
Total assets	1,208,584	1,332,278	1,266,142	865,124	709,886
Convertible senior notes, net	267,618	255,218	243,493	—	—
Other long-term liabilities	110,665	74,178	26,341	11,720	6,094
Total stockholders' equity	606,062	757,806	788,095	691,286	608,997

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report, including the following Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are based upon our current expectations. These forward-looking statements include statements related to our business strategy and plans, restructuring activities, technology initiatives, expectations regarding the seasonality and growth of our business, the impact on us of general economic conditions, trends in key metrics such as total number of customers and orders and average order value, the decline in average selling prices for prints, our capital expenditures for 2016, the sufficiency of our cash and cash equivalents and cash generated from operations for the next 12 months, our operating expenses remaining a consistent percentage of our net revenues, mergers and acquisitions and our ability to successfully integrate acquired technologies and services, our new production facilities, as well as other statements regarding our future operations, financial condition and prospects and business strategies. In some cases, you can identify forward-looking statements by terminology such as "project," "believe," "anticipate," "plan," "expect," "estimate," "intend," "continue," "should," "would "potentially," "will," or "may," or the negative of these terms or other comparable terminology. Forward-looking statements involve risks and uncertainties. Our actual results and the timing of events could differ materially from those anticipated in our forward-looking statements as a result of many factors, including but not limited to, general economic conditions in the United States, consumer sentiment, levels of consumer discretionary spending, the impact of seasonality on our business, whether we are able to expand our customer base and increase our product and service offering, competition in our marketplace, our ability to meet production requirements, unanticipated difficulties building the next generation Shutterfly platform and executing on our strategic restructuring activities, our ability to successfully integrate acquired businesses and assets, our ability to retain and hire necessary employees, including seasonal personnel, and appropriately staff our operations, our ability to develop innovative, new products and services on a timely and cost-effective basis, consumer acceptance of our new products and services, our ability to develop additional adjacent lines of business, unforeseen changes in expense levels, and the other risks set forth below under "Risk Factors" in Part I, Item 1A of this report. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. We assume no obligation to update any of the forward-looking statements after the date of this report or to compare these forward-looking statements to actual results.

Overview

We are the leading manufacturer and digital retailer of high-quality personalized products and services offered through a family of lifestyle brands. Our vision is to make the world a better place by helping people share life’s joy. Our mission is to build an unrivaled service that enables deeper, more personal relationships between our customers and those who matter most in their lives. Our primary focus is on helping consumers manage their memories through the powerful medium of photography. We provide a full range of personalized photo-based products and services that make it easy, convenient and fun for consumers to upload, edit, enhance, organize, find, share, create, print, and preserve their memories in a creative and thoughtful manner through our trusted premium lifestyle brands: Shutterfly, Tiny Prints, Wedding Paper Divas, ThisLife, MyPublisher, BorrowLenses and Groovebook.

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We generate the majority of our Consumer revenues by producing and selling professionally-bound photo books, greeting and stationery cards, personalized calendars, other photo-based merchandise and high-quality prints ranging in size from wallet-sized to jumbo-sized 20x30 enlargements. We generate the majority of our Enterprise revenues by printing and shipping direct marketing and other variable data print products and formats. We manufacture most of these items in our Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona production facilities. By controlling the production process in our own production facilities, we are able to produce high-quality products, innovate rapidly, maintain a favorable cost structure and ensure timely shipment to customers, even during peak periods of demand. Additionally, we sell a variety of photo-based merchandise that is currently manufactured for us by third parties, such as calendars, mugs, magnets, pillows and blankets. We generate substantially all of our revenue from sales originating in the United States and our sales cycle has historically been highly seasonal as we generate more than 50% of our total net revenues during our fiscal fourth quarter. Our operations and financial performance depend on general economic conditions in the United States, consumer sentiment and the levels of consumer discretionary spending. We closely monitor these economic measures as their trends are indicators of the health of the overall economy and are some of the key external factors that impact our business.

In 2015, we delivered record net revenues, which increased 15% year over year to more than $1 billion. This increase was driven by a 10% increase in revenue in our Consumer segment and a 94% increase in revenue from our Enterprise segment. We achieved this growth, while simultaneously focusing on long term strategic priorities and investments in consumer facing programs and infrastructure projects that will provide future scale and scope efficiencies. These included the following:

- We consolidated all of our locations in the greater Phoenix area in to our new production facility in Tempe, Arizona which opened in the second quarter of 2015. This new facility offers flexibility for future expansion.
- We closed our manufacturing operations in Elmsford, New York and transitioned the manufacturing work done at this facility to our Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona facilities. The small size of the Elmsford facility relative to our other facilities limited its ability to scale and drive efficiencies.
- We significantly grew our Enterprise segment as we entered into a multi-year agreement with a major Enterprise customer. We will continue to make investments in our Enterprise platform and seek additional partnerships.
- We made significant investments in our websites during the year which helped our websites and systems perform well and keep them available, especially in the record volume period of the fourth quarter.

In 2015, we have prioritized specific areas to continue our focus on long term strategic priorities and investments in consumer facing programs and infrastructure projects that will provide future scale and scope efficiencies. These included the following:

- In 2015, we continued our initiative to build the next generation of Shutterfly; Shutterfly 3.0. We began to intentionally slow investments and innovation in the Tiny Prints and Wedding Paper Divas technology to redirect resources to the new Shutterfly platform, which will allow these brands to be supported by a common set of shared technology services, including cart, creation paths, login, address book and media storage platform.
- In 2015, we decided to discontinue the Treat brand. Treat was originally launched as an early stage growth initiative over three years ago, and during that time we invested in building a distinct one-to-one card experience that has delighted our customers, but that failed to attract a large enough standalone user base. As of March 2015, customers were no longer able to place orders on Treat.com and they are now redirected to Shutterfly.com where we will enhance the one-to-one card experience under our flagship brand identity.
- In 2015, we continued to make investments in modernizing our technology platform. We improved the mobile experience, adding new features, functionality and products to our apps with a focus on our universal iOS mobile app. We made progress on our Shutterfly 3.0 platform that aims to address the friction points caused by fragmented storage options and limited organization and search capabilities, and will begin migrating customers to the new, integrated platform through out 2016. Additionally, we began building a scalable platform for the Enterprise business that will

enable our clients to optimize their integrated marketing campaigns.

Finally, we executed against our share repurchase program which was approved in October 2012 and increased in February 2015. During 2015, we purchased a total of 4,907,675 shares for a total repurchase amount of $215.9 million. We have $95.3 million remaining under our share repurchase program authorization at December 31, 2015.

Basis of Presentation

Net Revenues. Our net revenues are comprised of sales generated from Consumer and Enterprise segments.

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Consumer. Our Consumer revenues include sales from all of our brands and are derived from the sale of photo-based products, such as photo books, stationery and greeting cards, other photo-based merchandise, photo prints, and the related shipping revenues as well as rental revenue from our BorrowLenses brand. Included in our photo-based merchandise are items such as mugs, iPhone cases, desktop plaques, candles, pillows, canvas prints and blankets. Photo prints consist of wallet, 4x6, 5x7, 8x10, and large format sizes. Revenue from advertising displayed on our websites is also included in Consumer revenues.

Enterprise. Our Enterprise revenues are primarily from variable, four-color direct marketing collateral manufactured and fulfilled for business customers. We continue to focus our efforts in expanding our presence in this market.

	Year Ended December 31,		
	2015	2014	2013
Consumer			
Net revenues	$961,418	$870,959	$745,970
Cost of net revenues	436,050	394,265	327,145
Gross profit	$525,368	$476,694	$418,825
Gross profit as a percentage of net revenues	55 %	55 %	56 %
Enterprise			
Net revenues	$98,011	$50,621	$37,672
Cost of net revenues	79,789	43,456	29,480
Gross profit	$18,222	$7,165	$8,192
Gross profit as a percentage of net revenues	19 %	14 %	22 %
Corporate			
Net revenues	$—	$—	$—
Cost of net revenues	12,239	14,999	12,968
Gross profit	$(12,239)	$(14,999)	$(12,968)
Consolidated			
Net revenues	$1,059,429	$921,580	$783,642
Cost of net revenues	528,078	452,720	369,593
Gross profit	$531,351	$468,860	$414,049
Gross profit as a percentage of net revenues	50 %	51 %	53 %

In addition to the two reportable segments, we also have a corporate category that includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation and amortization of intangible assets.

Our Consumer segment is subject to seasonal fluctuations. In particular, we generate a substantial portion of our revenues during the holiday season in the fourth quarter. We also typically experience increases in net revenues during other shopping-related seasonal events, such as Easter, Mother’s Day, Father’s Day, and Halloween. We generally experience lower net revenues during the first, second and third calendar quarters and have incurred and may continue to incur losses in these quarters. Due to the relatively short lead time required to fulfill product orders, usually one to three business days, order backlog is not material to our business.

To further understand net revenue trends in our Consumer segment, we monitor several key metrics including, total customers, total number of orders, and average order value.

Total Customers.   We closely monitor total customers as a key indicator of demand. Total customers represents the number of transacting customers in a given period. We seek to expand our customer base by empowering our existing customers with sharing and collaboration services, and by conducting integrated marketing and advertising programs.

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We also acquire new customers through customer list acquisitions. Total customers have increased on an annual basis for each year since inception and we expect this trend to continue.

Total Number of Orders. We closely monitor total number of orders as a leading indicator of net revenue trends. We recognize net revenues associated with an order when the products have been shipped and all other revenue recognition criteria have been met. Orders are typically processed and shipped in approximately three business days after a customer places an order. Total number of orders has increased on an annual basis for each year since 2000, and we anticipate this trend to continue in the future.

Average Order Value. Average order value ("AOV") is Consumer net revenues for a given period divided by the total number of customer orders recorded during that same period. Average order value is impacted by product sales mix and pricing and promotional strategies, including our promotions and competitor promotional activity. As a result, we expect that our average order values may fluctuate on an annual basis.

Our Enterprise segment revenues are generated from the printing and shipping of direct marketing and other variable data print products and formats.

We believe the analysis of these metrics and others described below under "Non-GAAP Financial Measures" provides us with important information on our overall net revenue trends and operating results. Fluctuations in these metrics are not unusual and no single factor is determinative of our net revenues and operating results.

Cost of Net Revenues. Our cost of net revenues is split between our Consumer and Enterprise segments and our Corporate category.

Consumer. Cost of net revenues for the Consumer segment consists of costs directly attributable to the production of personalized products for all of our brands, including direct materials (the majority of which consists of paper, ink, and photo book covers), shipping charges, packing supplies, distribution and fulfillment activities, third-party costs for photobased merchandise, and payroll and related expenses for direct labor and customer service; rent for production facilities, and depreciation of production equipment and facilities where we are the deemed owner. Cost of net revenues also includes any third-party software or patents licensed, as well as the amortization of acquired developed technology, capitalized website and software development costs, and patent royalties. Cost of net revenues also includes certain costs associated with facility closures and restructuring.

Enterprise. Cost of net revenues for the Enterprise segment consists of costs which are direct and incremental to the Enterprise business. These included production costs of Enterprise products, such as materials, labor and printing costs and costs associated with third-party production of goods. They also include shipping costs and indirect overhead.

Corporate. Our corporate category includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation and amortization of intangible assets.

Operating Expenses. Operating expenses consist of technology and development, sales and marketing, and general and administrative expenses. We anticipate that each of the following categories of operating expenses will increase in absolute dollar amounts, but remain relatively consistent as a percentage of net revenues.

Technology and development expense consists primarily of personnel and related costs for employees and contractors engaged in the development and ongoing maintenance of our websites, infrastructure and software. These expenses include depreciation of the computer and network hardware used to run our websites and store the customer data, including data storage for our ThisLife brand service, as well as amortization of purchased software. Technology and development expense also includes co-location, power and bandwidth costs.

Sales and marketing expense consists of costs incurred for marketing programs, and personnel and related expenses for our customer acquisition, product marketing, business development, and public relations activities. Our marketing efforts consist of various online and offline media programs, such as e-mail and direct mail promotions, radio advertising, television advertising, the purchase of keyword search terms and various strategic alliances. We depend on these efforts to attract customers to our service.

General and administrative expense includes general corporate costs, including rent for our corporate offices, insurance, depreciation on information technology equipment, and legal and accounting fees. Transaction costs are also included in general and administrative expense. In addition, general and administrative expense includes personnel expenses of employees involved in executive, finance, accounting, human resources, information technology and legal roles. Third-party payment processor and credit card fees are also included in general and administrative expense and have historically fluctuated based on revenues during the period. All of the payments we have received from our intellectual property license agreements have been included as an offset to general and administrative expense.

Interest Expense. Interest expense consists of interest on our convertible senior notes arising from amortization of debt discount, amortization of debt issuance costs, and our 0.25% coupon payment; costs associated with our five-year syndicated credit facility that became effective in November 2011, as amended in May and December 2013; and costs associated with our capital leases and build-to-suit lease financing obligations.

Interest and Other Income, Net. Interest and other income, net primarily consists of the interest earned on our cash and investment accounts and realized gains and losses on the sale of our investments.

Income Taxes. We account for income taxes under the liability method. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities. We are subject to taxation in the United States and Israel.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation of our financial condition or results of operations will be affected.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management’s judgment in its application, while in other cases, management’s judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions. We believe that the accounting policies discussed below are the most critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management’s judgments and estimates.

Revenue Recognition. We recognize revenue from Consumer and Enterprise product sales, net of applicable sales tax, upon shipment of fulfilled orders, when persuasive evidence of an arrangement exists, the selling price is fixed or determinable and collection of resulting receivables is reasonably assured. Customers place Consumer product orders through our websites and pay primarily using credit cards. Enterprise customers are invoiced upon fulfillment. Shipping charged to customers is recognized as revenue at the time of shipment.

For camera, lenses, and video equipment rentals from our BorrowLenses brand, we recognize rental revenue and the related shipping and insurance revenue, ratably over the rental period. Revenue from the sale of rental equipment is recognized upon shipment of the equipment.

For gift card sales and flash deal promotions through group buying websites, we recognize revenue on a gross basis, as we are the primary obligor, when redeemed items are shipped. Revenues from sales of prepaid orders on our websites are deferred until shipment of fulfilled orders or until the prepaid period expires. Our share of revenue generated from our print to retail relationships, is recognized when orders are picked up by our customers at the respective retailer.

We provide our customers with a 100% satisfaction guarantee whereby products can be returned within a 30-day period for a reprint or refund. We maintain an allowance for estimated future returns based on historical data. The provision for estimated returns is included in accrued expenses. During the year ended December 31, 2015, returns totaled less than 1.3% of net revenues and have been within management’s expectations.

We periodically provide incentive offers to our customers in exchange for setting up an account and to encourage purchases. Such offers include free products and percentage discounts on current purchases. Discounts, when accepted by customers, are treated as a reduction to the purchase price of the related transaction and are presented in net revenues. Production costs related to free products are included in cost of revenues upon redemption.

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Our advertising revenues are derived from the sale of online advertisements on our websites. Advertising revenues are recognized as “impressions” (i.e., the number of times that an advertisement appears in pages viewed by users of the Company's websites) are delivered; as “clicks” (which are generated each time users of our websites click through the advertisements to an advertiser’s designated website) are provided to advertisers; or ratably over the term of the agreement with the expectation that the advertisement will be delivered ratably over the contract period.

In the second quarter of 2015, we changed our accounting estimate related to flash deal deferred revenue. Beginning in 2010, we began to market product offers on flash deal websites such as Groupon and LivingSocial. With limited history as to customer redemption patterns, we had been deferring all amounts to our flash deal deferred revenue liability until customer redemption. We now have sufficient relevant historical flash deal redemption data to support a change in estimate of the flash deal deferred revenue based on historical customer redemption patterns. The historical data supports the probability of redemption after two years from the issuance of a flash deal offer as remote. In addition, our attempts to re-market the unredeemed flash deals over the last six months resulted in no meaningful change in customer behavior. Accordingly, flash deal breakage revenue is now recognized based upon our historical redemption patterns. It represents the unredeemed flash deal offers for which we believe customer redemption is remote and it is not probable that we have an obligation to escheat the value of the flash deal revenue under unclaimed property laws. In the year ended December 31, 2015, we recognized revenue of $10.0 million associated with this change.

Certain Enterprise revenue arrangements with multiple deliverables, including products and services, are divided into separate units and revenue is allocated using estimated selling prices if we do not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables. We allocate the arrangement price to each of the elements based on the relative selling prices of each element. Estimated selling prices are management’s best estimates of the prices that we would charge our customers if we were to sell the standalone elements separately and include considerations of customer demand, prices charged by us and others for similar deliverables, and the price if largely based on the cost of producing the product or service. For up-front fees we received in exchange for products delivered or services performed, it is deferred and recognized over periods that the fees are earned. In cases in which an up-front fee is not related to specific products or services, the fee is excluded from the consideration that is allocated to the deliverables, and be recognized over the longer of the initial contractual term of the arrangement or the estimated period the customer is expected to benefit from the payment of the up-front fee.
Inventories. Our inventories consist primarily of paper, SBS materials, photo gifts, and packaging supplies and are stated at the lower of cost on a first-in, first-out basis or net realizable value. The value of inventories is reduced by an estimate for excess and obsolete inventories. The estimate for excess and obsolete inventories is based upon management’s review of utilization of inventories in light of projected sales, current market conditions and market trends.

Fair Value. We record our financial assets and liabilities at fair value. The accounting standard for fair value provides a framework for measuring fair value, clarifies the definition of fair value and expands disclosures regarding fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The accounting standard establishes a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Goodwill and Intangible Assets. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Intangible assets resulting from the acquisition of entities accounted for using the purchase method of accounting are estimated by management based on the fair value of assets received. Intangible assets are amortized on a straight-line basis over the estimated useful lives which range from one to sixteen years, and the amortization is allocated between cost of net revenues and operating expenses. Goodwill and intangible assets with indefinite lives are not subject to amortization, but are tested for impairment on an annual basis during our fourth quarter or whenever events or changes in circumstances indicate the carrying amount of these assets may not be recoverable.

For our annual goodwill impairment analysis, we operate under two reporting units. As part of the annual goodwill impairment test, we first perform a qualitative assessment to determine whether further impairment testing is necessary. If, as a result of this

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qualitative assessment, it is more-likely-than-not (i.e. greater than 50% chance) that the fair value of our reporting units is less than its carrying amounts, the quantitative impairment test will be required. Otherwise, no further testing will be required.

If it is determined, as a result of the qualitative assessment, that it is more-likely-than not that the fair value of our reporting unit is less than its carrying amount, the provisions of authoritative guidance require that we perform a two-step impairment test on goodwill. We test goodwill for impairment by first comparing the book value of net assets to the fair value of the reporting units. If the fair value is determined to be less than the book value, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value. We estimate the fair value of the reporting units using discounted cash flows. Forecasts of future cash flows are based on our best estimate of future net sales and operating expenses, based primarily on expected reporting unit expansion, pricing, market segment share, and general economic conditions.

Software and Website Development Costs. We capitalize costs associated with website development and software developed or obtained for internal use. Accordingly, payroll and payroll-related costs and stock-based compensation incurred in the development phase are capitalized and amortized over the product’s estimated useful life, which is generally three years. Costs associated with minor enhancements and maintenance for our website are expensed as incurred.

Income Taxes. We use the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized by applying the statutory tax rates in effect in the years in which the differences between the financial reporting and tax filing bases of existing assets and liabilities are expected to reverse. We have considered cumulative earnings and projected future earnings in assessing the need for a valuation allowance against our deferred tax assets. In 2015, our valuation allowance against certain California, South Carolina, and Arizona deferred tax assets increased to $8.2 million from $4.9 million in 2014. Based on our assessment, excluding the valuation allowance recorded related to certain Arizona, California and South Carolina deferred tax assets that are not likely to be realized, it is more likely than not that the Company’s U.S. net deferred tax asset will be realized through future taxable earnings, and/or the reversal of existing taxable temporary differences as of December 31, 2015. Accordingly, with exception of the valuation allowance discussed above, no additional valuation allowance has been recorded on net deferred tax assets as of December 31, 2015. Our business is cyclical and taxable income is highly dependent on revenue that historically has occurred during the fourth quarter. If there are changes to this historic trend and our fourth quarter does not yield results in-line with expectations, we may not be profitable in a given year resulting in a potential cumulative loss. If this were to occur, we would pursue any possible tax planning strategies that are feasible and prudent to avoid the expiration of our tax attributes. We will continue to assess the need for a valuation allowance in the future.

We report a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. We are required to make subjective assumptions and judgments regarding our income tax exposures. Interpretations and guidance surrounding income tax laws and regulations change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of operations.

Our policy is to recognize interest and/or penalties related to all tax positions in income tax expense. To the extent that accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision in the period that such determination is made.

Stock-Based Compensation Expense. We measure our stock based awards at fair value and recognize compensation expense for all share-based payment awards made to our employees and directors, including employee stock options and restricted stock awards.

We estimate the fair value of stock options granted using the Black-Scholes valuation model. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of our common stock price using historical and implied volatility and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in our consolidated statements of operations. We have not issued any stock options since the first quarter of 2013.

The cost of restricted stock awards and performance-based restricted stock awards is determined using the fair value of our common stock on the date of grant. Compensation expense is recognized for restricted stock awards on a straight-line basis over the vesting period. Compensation expense associated with performance-based restricted stock awards is recognized on an accelerated attribution model, and ultimately based on whether or not satisfaction of the performance criteria is probable. If in the future, situations indicate that the performance criteria are not probable, then no further compensation cost will be recorded, and

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any previous costs will be reversed. The cost of restricted stock awards with market conditions is estimated using a Monte-Carlo valuation model.

Employee stock-based compensation expense is calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Results of Operations

The following table presents the components of our statement of operations as a percentage of net revenues:

	Year Ended December 31,					
	2015		2014		2013	
Net revenues	100	%	100	%	100	%
Cost of net revenues	50		49		47	
Gross profit	50		51		53	
Operating expenses:						
Technology and development	15		14		14	
Sales and marketing	22		23		24	
General and administrative	11		12		12	
Total operating expenses	48		49		50	
Income from operations	2		2		3	
Interest expense	(2	)	(2	)	(1	)
Interest and other income, net	—		—		—	
Income/(loss) before income taxes	—		—		2	
Benefit from/(provision for) income taxes	—		—		(1	)
Net income/(loss)	—	%	—	%	1	%

Comparison of the Years Ended December 31, 2015 and 2014

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	Year Ended December 31,			
	2015	2014	$ Change	% Change
	(in thousands, except AOV amounts)			
Net revenues				
Consumer	$961,418	$870,959	$90,459	10 %
Enterprise	98,011	50,621	47,390	94 %
Corporate	—	—	—	—
Total net revenues	$1,059,429	$921,580	$137,849	15 %
Cost of net revenues				
Consumer	$436,050	$394,265	$41,785	11 %
Enterprise	79,789	43,456	36,333	84 %
Corporate	12,239	14,999	(2,760)	(18)%
Total cost of net revenues	$528,078	$452,720	$75,358	17 %
Gross profit				
Consumer	$525,368	$476,694	$48,674	10 %
Enterprise	18,222	7,165	11,057	154 %
Corporate	(12,239)	(14,999)	2,760	(18)%
Total gross profit	$531,351	$468,860	$62,491	13 %
Consumer gross margin percentage	55 %	55 %	— %	— %
Enterprise gross margin percentage	19 %	14 %	5 %	36 %
Consolidated gross margin percentage	50 %	51 %	(1)%	(2)%
Key Consumer Metrics				
Customers	9,751	9,206	545	6 %
Orders	25,806	21,773	4,033	19 %
Average order value (AOV)	$37.26	$40.00	$(2.74)	(7)%

Net revenues increased $138 million, or 15%, in 2015 compared to 2014. Revenue growth was attributable to increases in revenue from both reportable segments. Cost of net revenues increased $75.4 million, or 17%, in 2015 compared to 2014. As a percentage of net revenues, cost of net revenues increased to 50% in 2015 compared to 49% in 2014, with gross margin decreasing to 50% in 2015 from 51% in 2014.

Consumer Segment

Consumer net revenues increased $90.5 million, or 10%, in 2015 compared to 2014, and represented 91% of total net revenues in 2015. The increase in Consumer net revenues is primarily the result of increased sales of cards and stationary, a full year of Groovebook sales (acquired in October 2014), mobile revenue, and photo gifts. Consumer net revenues also benefited from a change in accounting estimate related to flash deal deferred revenue in the second quarter of 2015. The increase is also reflected in the increases in customers and orders in 2015 as compared to 2014, as noted in the above table. Average order value decreased slightly in 2015 as compared to 2014.

Consumer cost of net revenues increased $41.8 million in 2015 compared to 2014. Overall, the increase in cost of net revenues was primarily the result of the increased volume of shipped products as well as increased depreciation from our expanded manufacturing facilities and recently acquired production and rental equipment.

Enterprise Segment

Enterprise revenues increased $47.4 million, or 94%, in 2015 compared to 2014, and represented 9% of total net revenues in 2015. The increase was primarily due to the expansion of projects with existing customers and the acquisition of new customers. For example, in 2015 we signed a seven-year contract with a major Enterprise customer which resulted in a significant increase in Enterprise revenues for the year. Enterprise revenues in 2015 include $14.0 million in shipping revenue at zero margin that is not expected to recur.

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For our Enterprise segment, cost of net revenues increased $36.3 million in 2015 compared to 2014. The increase was primarily the result of the increased volume of shipped products in 2015 compared to 2014.

	Year Ended December 31,			
	2015	2014	$ Change	% Change
	(in thousands)			
Technology and development	$155,318	$133,623	$21,695	16 %
Percentage of net revenues	15 %	14 %	1 %	7 %
Sales and marketing	$236,749	$216,035	$20,714	10 %
Percentage of net revenues	22 %	23 %	(1)%	(4)%
General and administrative	$121,019	$112,957	$8,062	7 %
Percentage of net revenues	11 %	12 %	(1)%	(8)%

Our technology and development expense increased $21.7 million, or 16%, in 2015, compared to 2014. As a percentage of net revenues, technology and development expense increased to 15% in 2015 from 14% in 2014. The increase in technology and development expense was primarily due to an increase of $9.8 million in personnel and related costs, reflecting additional hires during 2015. There was also an increase of $4.6 million in depreciation expense primarily related to equipment for our new co-location facility, an increase of $5.7 million in professional fees, and an increase of $1.2 million in stock based compensation. These factors were partially offset by a decrease of $0.3 million in software and website development costs capitalized in the current period compared to the same period in the prior year.

During 2015, headcount in technology and development increased by 17% compared to 2014, reflecting our strategic focus to increase the rate of innovation in our product and services offerings, to generate greater differentiation from our competitors, and improve our long-term operating efficiency. In 2015, we capitalized $20.4 million in eligible salary and consultant costs, including $1.2 million of stock-based compensation, associated with software developed or obtained for internal use, compared to $20.1 million, which included $1.5 million of stock-based compensation capitalized in 2014.

Our sales and marketing expense increased $20.7 million, or 10%, in 2015 compared to 2014. As a percentage of net revenues, total sales and marketing expense decreased to 22% in 2015 from 23% in 2014. The increase in sales and marketing expense was primarily due to an increase of $20.1 million related to direct response, expanded online and performance marketing campaigns. The increase is also attributable to an increase of $1.9 million in personnel related costs associated with the expansion of our internal marketing team. This was partially offset by a decrease of $1.2 million in stock-based compensation, and a decrease of $0.4 million in intangible asset amortization.

Our general and administrative expense increased $8.1 million, or 7%, in 2015 compared to 2014. As a percentage of net revenues, general and administrative expense decreased to 11% in 2015 as compared to 12% in 2014. The increase in general and administrative expense is primarily due to an increase in personnel related costs of $3.3 million as a result of increased headcount and $1.9 million of executive severance. There was also an increase in loss on asset disposition of $1.1 million and an increase in credit card fees of $4.3 million which was driven by the increase in Consumer net revenues as compared to the prior year. This was partially offset by a decrease in depreciation and amortization of $1.8 million.

	Year Ended December 31,		
	2015	2014	Change
	(in thousands)		
Interest expense	$(20,998)	$(16,732)	$(4,266)
Interest and other income, net	744	508	236

Interest expense consists of interest on our convertible senior notes arising from amortization of debt discount, amortization of debt issuance costs, our 0.25% coupon, issuance costs associated with our credit facility, capital leases, and our financing obligations associated with our production facilities in Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona. Interest expense was $21.0 million for the year ended December 31, 2015 compared to $16.7 million during 2014. The increase in interest expense is primarily due to an increase of $1.9 million related to our build-to-suit leases from our three production facilities, an increase of $1.8 million related to our manufacturing equipment capital leases, and an increase of $0.7 million related to our convertible senior notes.

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	Year Ended December 31,	
	2015	2014
	(in thousands)	
Income tax benefit	$1,146	$2,119
Effective tax rate	58 %	21 %

The benefit for income taxes was $1.1 million for 2015, compared to a benefit of $2.1 million for 2014. The current year tax benefit was mainly due to the loss before income taxes. Our effective tax rate was 58% in 2015 and 21% in 2014. The year over year change in our effective tax rate was primarily the result of a higher federal research and development credit benefit, the release and re-measurement of reserves related to the settlement of our 2010 IRS audit, a reduced limitation on executive compensation, and the establishment of valuation allowances on certain Arizona deferred tax assets.

	Year Ended December 31,			
	2015	2014	$ Change	% Change
	(in thousands)			
Income/(loss) before income taxes	$(1,989)	$(9,979)	$7,990	(80)%
Net income/(loss)	(843)	(7,860)	7,017	(89)%
Percentage of net revenues	— %	— %	—	— %

Comparison of the Years Ended December 31, 2014 and 2013

	Year Ended December 31,			
	2014	2013	$ Change	% Change
	(in thousands, except AOV amounts)			
Net revenues				
Consumer	$870,959	$745,969	$124,990	17 %
Enterprise	50,621	37,673	12,948	34 %
Total net revenues	$921,580	$783,642	$137,938	18 %
Cost of net revenues	452,720	369,593	83,127	22 %
Gross profit	$468,860	$414,049	$54,811	13 %
Gross margin percentage	51 %	53 %	— %	— %
Key Consumer Metrics				
Customers	9,206	8,094	1,112	14 %
Orders	21,773	18,561	3,212	17 %
Average order value (AOV)	$40.00	$40.19	$(0.19)	— %

Net revenues increased $137.9 million, or 18%, in 2014 compared to 2013. Revenue growth was attributable to increases in both reportable segments. Consumer net revenues increased $125.0 million, or 17%, in 2014 compared to 2013, and represented 95% of total net revenues in 2014 in line with 2013. The increase in Consumer net revenues is primarily the result of increased sales of greeting and stationery cards, photo books and a full year of BorrowLenses revenues. The increase is also reflected in the increases in customers and orders in 2014 as compared to 2013, as noted above.

Average order value remained flat in 2014 as compared to 2013. Enterprise revenues increased $12.9 million, or 34%, in 2014 compared to 2013, and represented 5% of total net revenues in 2014 in line with 2013. The increase is a combination of new Enterprise customers as well as increased sales to existing customers.

Cost of net revenues increased $83.1 million, or 22%, in 2014 compared to 2013. As a percentage of net revenues, cost of net revenues increased to 49% in 2014 compared to 47% in 2013, with gross margin decreasing to 51% in 2014 from 53% in 2013. For our Consumer segment, cost of net revenues increased $67.1 million in 2014 compared to 2013. Overall, the increase in cost of net revenues was primarily the result of the increased volume of shipped products as well as increased depreciation from our expanded and recently acquired manufacturing facilities and production and rental equipment. For our Enterprise segment, cost of net revenues increased $14.0 million in 2014 compared to 2013. The increase was primarily the result of the increased volume of shipped products in 2014 compared to 2013.

	Year Ended December 31,			
	2014	2013	$ Change	% Change
	(in thousands)			
Technology and development	$133,623	$108,995	$24,628	23 %
Percentage of net revenues	14 %	14 %	—	—
Sales and marketing	$216,035	$189,985	$26,050	14 %
Percentage of net revenues	23 %	24 %	—	—
General and administrative	$112,957	$93,011	$19,946	21 %
Percentage of net revenues	12 %	12 %	—	—

Our technology and development expense increased $24.6 million, or 23%, in 2014, compared to 2013. As a percentage of net revenues, technology and development expense remained flat at 14% in 2014 and 2013. The increase in technology and development expense was primarily due to an increase of $10.6 million in personnel and related costs, reflecting additional hires during 2014. There was also an increase of $9.3 million in depreciation expense primarily related to equipment for our new co-location facility, an increase of $5.8 million in professional fees, and an increase of $3.1 million in facility costs primarily from co-location services. These factors were partially offset by an increase of $4.8 million in software and website development costs capitalized and a decrease in stock based compensation of $0.4 million in the current period compared to the same period in the prior year.

During 2014, headcount in technology and development increased by 11% compared to 2013, reflecting our strategic focus to increase the rate of innovation in our product and services offerings, to generate greater differentiation from our competitors, and improve our long-term operating efficiency. In 2014, we capitalized $20.1 million in eligible salary and consultant costs, including $1.5 million of stock-based compensation, associated with software developed or obtained for internal use, compared to $15.3 million, which included $1.7 million of stock-based compensation capitalized in 2013.

Our sales and marketing expense increased $26.1 million, or 14%, in 2014 compared to 2013. As a percentage of net revenues, total sales and marketing expense increased to 23% in 2014 from 24% in 2013. The increase in sales and marketing expense was primarily due to an increase of $16.1 million related to direct response, expanded online and performance marketing campaigns. The increase is also attributable to an increase of $5.0 million in personnel and related costs associated with the expansion of our internal marketing team, an increase of $2.9 million in stock-based compensation, and an increase of $1.5 million in intangible asset amortization primarily from intangibles acquired in the 2013 acquisitions of MyPublisher and BorrowLenses.

Our general and administrative expense increased $19.9 million, or 21%, in 2014 compared to 2013. As a percentage of net revenues, general and administrative expense remained flat at 12% in 2014 as compared to 2013. The increase in general and administrative expense is primarily due to an increase in stock-based compensation of $4.4 million and an increase in personnel related costs of $4.2 million as a result of increased headcount. There was also an increase in credit card fees of $3.5 million which was driven by the increase in Consumer net revenues as compared to the prior year, an increase in depreciation and amortization of $3.4 million, an increase in professional fees of $2.5 million, and an increase in facility costs of $1.9 million, offset by proceeds from intellectual property license agreements of $0.6 million.

	Year Ended December 31,		
	2014	2013	Change

	(in thousands)		
Interest expense	$(16,732)	$(9,446)	$(7,286)
Interest and other income, net	508	308	200

Interest expense consists of interest on our convertible senior notes arising from amortization of debt discount, amortization of debt issuance costs, and our 0.25% coupon, issuance costs associated with our credit facility; capital leases and our financing obligation associated with our Fort Mill, South Carolina production facility. Interest expense was $16.7 million for the year ended December 31, 2014 compared to $9.4 million during 2013. The increase in interest expense is primarily due to an increase of $5.5 million associated with our May 2013 issuance of $300.0 million of 0.25% convertible senior notes, an increase of $1.2 million

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related to our build-to-suit leases from our Fort Mill and Shakopee production facilities, an increase of $0.5 million related to our credit facility and an increase of $0.1 million related to our capital leases.

	Year Ended December 31,	
	2014	2013
	(in thousands)	
Income tax benefit/(provision)	$2,119	$(3,635)
Effective tax rate	21%	28%

The benefit for income taxes was $2.1 million for 2014, compared to a provision for income taxes of $3.6 million for 2013. The current year tax benefit was due to the loss before income taxes. Our effective tax rate was 21% in 2014 and 28% in 2013. The year over year change in our effective tax rate was primarily the result of higher non-deductible executive compensation, a lower federal research and development credit benefit and a decrease in disqualifying dispositions of incentive stock option awards.

	Year Ended December 31,			
	2014	2013	$ Change	% Change
	(in thousands)			
Income/(loss) before income taxes	$(9,979)	$12,920	$(22,899)	(177)%
Net income/(loss)	(7,860)	9,285	(17,145)	(185)%
Percentage of net revenues	—%	1%	—%	—%

Liquidity and Capital Resources

At December 31, 2015, we had $288.9 million of cash and $51.9 million of investments, primarily agency securities and corporate bonds. To supplement our overall liquidity position, during the year ended December 31, 2013, we issued $300.0 million of 0.25% convertible senior notes due May 15, 2018. We also have had access to a five-year senior secured syndicated credit facility to provide up to $200.0 million in additional capital resources which expires in November 2016. As of December 31, 2015, no amounts have been drawn against this facility. For information about our repurchases of shares of our common stock during the years ended December 31, 2015 and 2014, see Part II, Item 8 of this annual report on Form 10-K “Financial Statements and Supplementary Data-Notes to Consolidated Financial Statements-Note 11-Share Repurchase Program.”

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Below is our cash flow activity for the years ended December 31, 2015, 2014 and 2013:

	Year Ended December 31,		
	2015	2014	2013
	(in thousands)		
Consolidated Statements of Cash Flows Data:			
Purchases of property and equipment	$55,448	$71,169	$62,582
Capitalization of software and website development costs	21,221	21,032	15,760
Depreciation and amortization	113,277	98,752	74,856
Acquisition of business and intangible assets, net of cash acquired	127	12,000	76,893
Cash flows provided by operating activities	165,037	166,488	147,268
Cash flows used in investing activities	(33,117)	(197,428)	(154,847)
Cash flows provided by/(used in)financing activities	(223,600)	(87,601)	261,575

We anticipate that our current cash balance and cash generated from operations will be sufficient to meet our strategic and working capital requirements, lease obligations, share repurchase program, technology development projects, and coupon payments for our 0.25% convertible senior notes for at least the next twelve months. Whether these resources are adequate to meet our liquidity needs beyond that period will depend on our growth, operating results and the capital expenditures required to meet possible increased demand for our products. If we require additional capital resources to grow our business internally or to acquire complementary technologies and businesses at any time in the future, we may seek to sell additional debt or additional equity. The sale of additional equity or convertible debt could result in significant dilution to our stockholders. Financing arrangements may not be available to us, or may not be in amounts or on terms acceptable to us.

We anticipate that total 2016 capital expenditures will range from 7% to 8% of our expected net revenues in 2016. These expenditures will be used to make developments to Shutterfly 3.0, to improve mobile capabilities, to develop the SBS platform, to purchase technology and equipment to support the growth in our business, to increase our production capacity, and help enable us to respond more quickly and efficiently to customer demand. This range of capital expenditures is not outside the ordinary course of our business or materially different from how we have expanded our business in the past.

The following table shows total capital expenditures including amounts accrued but not yet paid by category for the years ended December 31, 2015, 2014 and 2013:

	Year Ended December 31,		
	2015	2014	2013
	(in thousands)		
Technology equipment and software	$36,380	$37,711	$31,935
Percentage of total capital expenditures	45 %	42 %	42 %
Manufacturing equipment and building improvements	18,478	26,872	26,880
Percentage of total capital expenditures	23 %	30 %	36 %
Capitalized technology and development costs	22,113	21,748	15,760
Percentage of total capital expenditures	27 %	24 %	21 %
Rental Equipment	4,407	3,912	395
Percentage of total capital expenditures	5 %	4 %	1 %
Total Capital Expenditures	$81,378	$90,243	$74,970
Total Capital Expenditures percentage of net revenues	8 %	10 %	10 %

Operating Activities. For 2015, net cash provided by operating activities was $165.0 million. Adjustments for non-cash items included $86.3 million of depreciation and amortization, which increased by $21.4 million over the prior year due to an increase in equipment capital leases and additional built-to-suit lease arrangements during the year. Additional adjustments for non-cash items included $60.5 million of stock-based compensation, and $27.0 million of amortization of intangible assets. Net cash provided by operating activities was also adjusted for amortization of debt discount and transaction costs of $13.6 million and the net change in operating assets and liabilities of $19.4 million primarily driven by a change in accounts receivable resulting from Enterprise customers.

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For 2014, net cash provided by operating activities was $166.5 million, primarily due to our net loss of $7.9 million and adjustments for non-cash items including $64.9 million of depreciation and amortization, $61.8 million of stock-based compensation, and $33.9 million of amortization of intangible assets. Net cash provided by operating activities was also adjusted for amortization of debt discount and transaction costs of $12.9 million and the net change in operating assets and liabilities of $4.4 million.

For 2013, net cash provided by operating activities was $147.3 million, primarily due to our net income of $9.3 million and adjustments for non-cash items including $53.5 million of stock-based compensation, $43.9 million of depreciation and amortization, and $31.0 million of amortization of intangible assets. Net cash provided by operating activities was also adjusted for amortization of debt discount and transaction costs of $7.7 million and the net change in operating assets and liabilities of $2.2 million.

Investing Activities. For 2015, net cash used in investing activities was $33.1 million. We used $31.1 million to purchase investments, $55.4 million for capital expenditures for computer and network hardware to support our website infrastructure and information technology systems, and for production equipment for our manufacturing operations, and $21.2 million for capitalized software and website development. This was partially offset from proceeds from the sales and maturities of investments of $73.5 million and proceeds from the sale of equipment and rental assets of $1.3 million, respectively.

For 2014, net cash used in investing activities was $197.4 million. We used $124.1 million to purchase investments. We used $71.2 million for capital expenditures for computer and network hardware to support our website infrastructure and information technology systems and for production equipment for our manufacturing and production operations, $21.0 million for capitalized software and website development, and $12.0 million to acquire certain assets of Groovebook. This was partially offset from proceeds from the sales and maturities of investments, and equipment and rental assets of $30.0 million and $0.9 million, respectively.

For 2013, net cash used in investing activities was $154.8 million. We used $76.9 million to acquire MyPublisher, R&R Images, and BorrowLenses, net of cash acquired, and to settle other acquisition related liabilities. We used $62.6 million for capital expenditures for computer and network hardware and production equipment for our manufacturing operations, and $15.8 million of capitalized software and website development. Additionally, we received proceeds of $0.4 million from the sale of equipment.

Financing Activities. For 2015, net cash used in financing activities was $223.6 million. We used $215.9 million to repurchase shares of our common stock and $12.7 million for payments of capital leases and financing obligations. We also received $3.2 million of proceeds from issuance of common stock from the exercise of options and recorded $1.8 million from excess tax benefit from stock-based compensation.

For 2014, net cash used in financing activities was $87.6 million. We used $88.8 million to repurchase shares of our common stock and $3.1 million for payments of capital leases and financing obligations. We also received $3.2 million of proceeds from issuance of common stock from the exercise of options and recorded $1.0 million from excess tax benefit from stock-based compensation.

For 2013, net cash provided by financing activities was $261.6 million, primarily from the $291.9 million in proceeds from the issuance of our 0.25% convertible senior notes in May 2013, $43.6 million in proceeds from the issuance of warrants, offset by $63.5 million from the purchase of a convertible note hedge and repurchases of common stock of $32.2 million. We also received $19.1 million of proceeds from issuance of common stock from the exercise of options and recorded $3.6 million from excess tax benefit from stock-based compensation.

Non-GAAP Financial Measures

Regulation G, conditions for use of Non-Generally Accepted Accounting Principles ("Non-GAAP") financial measures, and other SEC regulations define and prescribe the conditions for use of certain Non-GAAP financial information. We closely monitor three financial measures, adjusted EBITDA, free cash flow, and Non-GAAP earnings per share which meet the definition of Non-GAAP financial measures. We define adjusted EBITDA as earnings before interest, taxes, depreciation, amortization, and stock-based compensation. Free cash flow is defined as adjusted EBITDA less purchases of property and equipment and capitalization of software and website development costs. Free cash flow has limitations due to the fact that it does not represent the residual cash flow for discretionary expenditures. For example, free cash flow does not incorporate payments made on capital lease obligations or cash requirements to comply with debt covenants. Non-GAAP earnings per share is defined as Non-GAAP net income (loss), which excludes interest expense related to the issuance of our 0.25% convertible senior notes in May 2013, divided by diluted non-GAAP shares outstanding, which is GAAP weighted average shares outstanding less any shares issuable under our convertible senior notes. Management believes these Non-GAAP financial measures reflect an additional way of viewing our

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profitability and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our earnings and cash flows. Refer below for a reconciliation of adjusted EBITDA, free cash flow, and Non-GAAP earnings per share to the most comparable GAAP measure.

To supplement our consolidated financial statements presented on a GAAP basis, we believe that these Non-GAAP measures provide useful information about our core operating results and thus are appropriate to enhance the overall understanding of our past financial performance and our prospects for the future. These adjustments to our GAAP results are made with the intent of providing both management and investors a more complete understanding of our underlying operational results and trends and performance. Management uses these Non-GAAP measures to evaluate our financial results, develop budgets, manage expenditures, and determine employee compensation. The presentation of additional information is not meant to be considered in isolation or as a substitute for or superior to net income (loss) or net income (loss) per share determined in accordance with GAAP. We believe that it is important to view free cash flow as a complement to our reported consolidated financial statements. Management strongly encourages shareholders to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

The table below shows the trend of adjusted EBITDA and free cash flow as a percentage of net revenues and Non-GAAP net income per share for the years ended December 31, 2015, 2014, and 2013 (in thousands):

	Year Ended December 31,		
	2015	2014	2013
Net revenues	$1,059,429	$921,580	$783,642
Non-GAAP Adjusted EBITDA	$192,000	$166,759	$150,442
EBITDA % of Net revenues	18 %	18 %	19 %
Free cash flow	$110,621	$76,516	$75,472
Free cash flow % of Net revenues	10 %	8 %	10 %
Non-GAAP net income per share	$0.14	$0.07	$0.38

We carefully manage our operating costs and capital expenditures, in order to make the strategic investments necessary to grow and strengthen our business, while at the same time increasing our adjusted EBITDA and improving our free cash flows. Over the last three years, our full year adjusted EBITDA has improved to $192.0 million in 2015 from $150.4 million in 2013. This continued growth in adjusted EBITDA resulted from increased demand for our products and services, scale efficiencies, and improvements from product and services mix. The increase in adjusted EBITDA is also driven by higher net revenues in 2015 as compared to prior years. We also increased our free cash flow to $110.6 million in 2015 from $75.5 million in 2013.

The following is a reconciliation of adjusted EBITDA, free cash flow, and Non-GAAP net income per share to the most comparable GAAP measure, for the years ended December 31, 2015, 2014, and 2013 (in thousands, except per share amounts):

Reconciliation of Net Income/(Loss) to Non-GAAP Adjusted EBITDA

	Year Ended December 31,		
	2015	2014	2013
Net income/(loss)	$(843)	$(7,860)	$9,285
Add back:			
Interest expense	20,998	16,732	9,446
Interest and other income, net	(744)	(508)	(308)

Tax (benefit)/expense	(1,146)	(2,119)	3,635
Depreciation and amortization	113,277	98,752	74,856
Stock-based compensation expense	60,458	61,762	53,528
Non-GAAP Adjusted EBITDA	$192,000	$166,759	$150,442

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Reconciliation of Cash Flow from Operating Activities to Non-GAAP Adjusted EBITDA and Free Cash Flow

	Year Ended December 31,		
	2015	2014	2013
Net cash provided by operating activities	$165,037	$166,488	$147,268
Add back:			
Interest expense	20,998	16,732	9,446
Interest and other income, net	(744)	(508)	(308)
Tax (benefit)/expense	(1,146)	(2,119)	3,635
Changes in operating assets and liabilities	19,393	(4,360)	(2,226)
Other adjustments	(11,538)	(9,474)	(7,373)
Non-GAAP Adjusted EBITDA	192,000	166,759	150,442
Less:			
Purchases of property and equipment, including accrued amounts	(59,266)	(68,495)	(59,210)
Capitalized software and website development costs, including accrued amounts	(22,113)	(21,748)	(15,760)
Free cash flow	$110,621	$76,516	$75,472

Reconciliation of Net Income/(Loss) per Share to Non-GAAP Net Income per Share

	Year Ended December 31,		
	2015	2014	2013
GAAP net income/(loss)	$(843)	$(7,860)	$9,285
Add back interest expense related to:			
Amortization of debt discount	12,400	11,726	7,002
Amortization of debt issuance costs	1,247	1,179	705
0.25% coupon	750	$750	469
Tax effect	(8,293)	(2,900)	(2,300)
Non-GAAP net income	$5,261	$2,895	$15,161
GAAP basic shares outstanding	36,761	38,452	37,680
Add back:			
Dilutive effect of stock options and restricted awards	—	—	1,813
GAAP diluted shares outstanding	36,761	38,452	39,493
Add back:			
Dilutive effect of stock options and restricted awards	1,721	1,442	—
Dilutive effect of convertible notes	—	—	—
Non-GAAP diluted shares outstanding	38,482	39,894	39,493
GAAP net income/(loss) per share	$(0.02)	$(0.20)	$0.24
Non-GAAP net income per share	$0.14	$0.07	$0.38

Contractual Obligations

The following are contractual obligations at December 31, 2015, associated with lease obligations and other arrangements:

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	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	(in thousands)				
Contractual Obligations					
Convertible Senior Notes, including interest	$301,875	$750	$301,125	$—	$—
Capital lease obligations	63,728	16,147	30,923	15,171	1,487
Operating lease obligations (1)	22,547	8,606	10,255	1,934	1,752
Build-to-suit lease obligations (2)	58,547	6,082	12,576	13,147	26,742
Purchase obligations (3)	88,803	24,131	37,992	26,680	—
Total contractual obligations	$535,500	$55,716	$392,871	$56,932	$29,981

(1) Includes office space in Redwood City and Santa Clara, California and certain production facilities under non-cancelable operating leases. We also have various non-cancelable operating leases for certain production equipment.

(2) Includes the estimated timing and amount of payments for rent for our leased production facility spaces in Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona. See Part II, Item 8 of this annual report on Form 10-K “Financial Statements and Supplementary Data - Notes to Consolidated Financial Statements - Note 7 - Commitments and Contingencies” for further discussion.

(3) Includes co-location agreements with third-party hosting facilities that expire in 2020 as well as minimums under marketing agreements.

Other than the obligations, liabilities and commitments described above, we have no significant unconditional purchase obligations or similar instruments. We are not a guarantor of any other entities’ debt or other financial obligations.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not have any undisclosed borrowings or debt and we have not entered into any synthetic leases. We are, therefore, not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

In May 2014, the Financial Accountings Standards Board ("FASB") issued new accounting guidance related to revenue recognition. This new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for us beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. We are evaluating the impact, if any, of adopting this new accounting guidance on our financial statements.

In August 2014, the FASB issued new guidance related to the disclosures around going concern. The new standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on our financial statements.

In April 2015, the FASB issued new guidance related to presentation of debt issue costs. The new standard requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The adoption of this guidance will be effective beginning January 1, 2016, and is not expected to have a material impact on our financial statements.

In April 2015, the FASB issued new guidance related to accounting for fees paid in a cloud computing arrangement. The new standard provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud

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computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. We are evaluating the impact, if any, of adopting this new accounting guidance on our financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory - Simplifying the Measurement of Inventory (Topic 330). ASU 2015-11 requires inventory to be subsequently measured using the lower of cost and net realizable value, thereby eliminating the market value approach. Net realizable value is defined as the "estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation." ASU 2015-11 is effective for reporting periods beginning after December 15, 2016 and is applied prospectively. Early adoption is permitted. We are evaluating the impact, if any, of adopting this new accounting guidance on its financial statements.

In September 2015, the FASB issued new guidance related to business combinations. The new guidance requires that adjustments made to provisional amounts recognized in a business combination be recorded in the period such adjustments are determined, rather than retrospectively adjusting previously reported amounts. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. We are evaluating the impact, if any, of adopting this new accounting guidance on our consolidated financial statements.

In November 2015, the FASB issued new guidance related to balance sheet classification of deferred taxes. The standard update requires that deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. The amendments in this update are effective for reporting periods beginning after December 15, 2016. Early adoption is permitted. We early adopted ASU 2015-17 effective December 31, 2015 on a prospective basis. Adoption of this ASU resulted in a reclassification of our net current deferred tax asset to the net non-current deferred liability in our consolidated balance sheet as of December 31, 2015. No prior periods were retrospectively adjusted.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate and Credit Risk. We have exposure to interest rate risk that relates primarily to our investment portfolio and our syndicated credit facility. We maintain our portfolio of cash equivalents and investments in a variety of agency bonds and corporate debt securities. All of our cash equivalents are carried at market value. We may draw funds from our syndicated credit facility under interest rates based on either the Federal Funds Rate or the Adjusted London Interbank Offered Rate ("LIBO rate"). If these rates increase significantly, our costs to borrow these funds will also increase. To date, we have not borrowed any funds under our syndicated credit facility. We do not believe that a 10% change in interest rates would have a significant impact on our interest income and expense, operating results, or liquidity.

Market Risk and Market Interest Risk. In May 2013, we issued $300.0 million of 0.25% convertible senior notes due May 15, 2018. We carry this instrument at face value less unamortized discount on our balance sheet. Since this instrument bears interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of these instruments fluctuates when interest rates change, and in the case of convertible notes, when the market price of our stock fluctuates.

Inflation. We do not believe that inflation has had a material effect on our current business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, for example, if the cost of our materials or the cost of shipping our products to customers were to incur substantial increases as a result of the rapid rise in the cost of oil, 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.

Investment. The primary objective of our investment activities is to preserve principal while at the same time improving yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of asset types, including bank deposits, money market funds, agency bonds and corporate debt securities. As of December 31, 2015, our investments totaled $51.9 million, which represented approximately 67% of our total investment portfolio.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SHUTTERFLY, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Shutterfly, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income/(loss), stockholders' equity and cash flows present fairly, in all material respects, the financial position of Shutterfly, Inc. and its subsidiaries at December 31, 2015 and December 31, 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it classifies deferred tax assets and liabilities on the consolidated balance sheet in 2015.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

San Jose, California
February 12, 2016

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SHUTTERFLY, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except par value amounts)

	December 31, 2015	2014
ASSETS		
Current assets:		
Cash and cash equivalents	$288,863	$380,543
Short-term investments	22,918	64,866
Accounts receivable, net	55,222	31,105
Inventories	13,466	13,016
Deferred tax asset, current portion	—	34,645
Prepaid expenses and other current assets	33,147	24,983
Total current assets	413,616	549,158
Long-term investments	29,005	29,928
Property and equipment, net	281,779	241,742
Intangible assets, net	62,323	87,950
Goodwill	408,975	408,975
Deferred tax asset, net of current portion	1,710	549
Other assets	11,176	13,976
Total assets	$1,208,584	$1,332,278
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$35,329	$30,086
Accrued liabilities	149,134	135,485
Deferred revenue	27,329	31,415
Total current liabilities	211,792	196,986
Convertible senior notes, net	267,618	255,218
Deferred tax liability	12,447	48,090
Other liabilities	110,665	74,178
Total liabilities	602,522	574,472
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, $0.0001 par value; 100,000 shares authorized; 34,777 and 37,906 shares issued and outstanding on December 31, 2015 and December 31, 2014, respectively	4	4
Additional paid-in capital	900,218	838,313
Accumulated other comprehensive loss	(68)	(53)
Accumulated deficit	(294,092)	(80,458)
Total stockholders' equity	606,062	757,806
Total liabilities and stockholders' equity	$1,208,584	$1,332,278

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

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SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended December 31,		
	2015	2014	2013
Net revenues	$1,059,429	$921,580	$783,642
Cost of net revenues	528,078	452,720	369,593
Gross profit	531,351	468,860	414,049
Operating expenses:			
Technology and development	155,318	133,623	108,995
Sales and marketing	236,749	216,035	189,985
General and administrative	121,019	112,957	93,011
Total operating expenses	513,086	462,615	391,991
Income from operations	18,265	6,245	22,058
Interest expense	(20,998)	(16,732)	(9,446)
Interest and other income, net	744	508	308
Income/(loss) before income taxes	(1,989)	(9,979)	12,920
Benefit from/(provision for) income taxes	1,146	2,119	(3,635)
Net income/(loss)	$(843)	$(7,860)	$9,285
Net income/(loss) per share:			
Basic	$(0.02)	$(0.20)	$0.25
Diluted	$(0.02)	$(0.20)	$0.24
Weighted average shares:			
Basic	36,761	38,452	37,680
Diluted	36,761	38,452	39,493
Stock-based compensation is allocated as follows (Notes 2 and 8):			
Cost of net revenues	$4,134	$3,657	$2,485
Technology and development	10,840	9,236	9,477
Sales and marketing	21,512	22,670	19,774
General and administrative	23,972	26,199	21,792

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

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SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Year Ended December 31,		
	2015	2014	2013
Common stock (par value)			
Balance, beginning of year	$4	$4	$4
Issuance of common stock upon exercise of options and vesting of restricted stock units	1	1	1
Common stock repurchased and retired	(1)	(1)	(1)
Balance, end of year	4	4	4
Additional paid-in capital			
Balance, beginning of year	838,313	771,875	652,110
Issuance of common stock upon exercise of options and vesting of restricted stock units	3,221	3,243	19,112
Stock based compensation, net of forfeitures	61,705	63,358	55,237
Accelerated share repurchase of common stock	(3,119)	—	—
Tax benefit/(shortfall) of stock options	98	(163)	2,957
Equity component of the convertible note issuance, net	—	—	62,409
Purchase of convertible note hedge	—	—	(63,510)
Sale of warrants	—	—	43,560
Balance, end of year	900,218	838,313	771,875
Accumulated other comprehensive loss			
Balance, beginning of year	(53)	—	—
Unrealized loss on investments, net of tax	(15)	(53)	—
Balance, end of year	(68)	(53)	—
Accumulated earnings/(deficit)			
Balance, beginning of year	(80,458)	16,216	39,172
Common stock repurchased and retired	(212,791)	(88,814)	(32,241)
Net income/(loss)	(843)	(7,860)	9,285
Balance, end of year	(294,092)	(80,458)	16,216
Total stockholders' equity	$606,062	$757,806	$788,095
Number of shares			
Common stock			
Balance, beginning of year	37,906	38,196	36,358
Issuance of common stock upon exercise of options and vesting of restricted stock units	1,780	1,671	2,540
Common stock repurchased and retired	(4,909)	(1,961)	(702)
Balance, end of year	34,777	37,906	38,196

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

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SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)
(In thousands)

	Year Ended December 31,		
	2015	2014	2013
Net income/(loss)	$(843)	$(7,860)	$9,285
Other comprehensive loss, net of reclassification adjustments:			
Unrealized losses on investments, net	(24)	(87)	—
Tax benefit on unrealized losses on investments, net	9	34	—
Other comprehensive loss, net of tax	(15)	(53)	—
Comprehensive income/(loss)	$(858)	$(7,913)	$9,285

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

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SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2015	2014	2013
Cash flows from operating activities:			
Net income/(loss)	$(843)	$(7,860)	$9,285
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:			
Depreciation and amortization	86,290	64,885	43,887
Amortization of intangible assets	26,987	33,867	30,969
Amortization of debt discount and transaction costs	13,647	12,905	7,707
Stock-based compensation, net of forfeitures	60,458	61,762	53,528
Loss on disposal of property and equipment and rental assets	1,755	361	13
Deferred income taxes	(2,149)	(2,604)	331
Tax benefit/(shortfall) from stock-based compensation	98	(163)	2,957
Excess tax benefits from stock-based compensation	(1,813)	(1,025)	(3,635)
Changes in operating assets and liabilities:			
Accounts receivable, net	(24,117)	(9,464)	(7,174)
Inventories	(450)	(3,388)	(3,681)
Prepaid expenses and other current assets	(8,163)	(3,958)	(4,347)
Other assets	727	(1,442)	(7,669)
Accounts payable	3,139	(1,275)	3,583
Accrued and other liabilities	5,211	18,273	16,089
Deferred revenue	(4,085)	7,301	5,258
Other non-current liabilities	8,345	(1,687)	167
Net cash provided by operating activities	165,037	166,488	147,268
Cash flows from investing activities:			
Acquisition of business and intangible assets, net of cash acquired	(127)	(12,000)	(76,893)
Purchases of property and equipment	(55,448)	(71,169)	(62,582)
Capitalization of software and website development costs	(21,221)	(21,032)	(15,760)
Purchases of investments	(31,073)	(124,111)	—
Proceeds from the maturities of investments	62,944	29,130	—
Proceeds from the sales of investments	10,510	850	—
Proceeds from sale of property and equipment and rental assets	1,298	904	388
Net cash used in investing activities	(33,117)	(197,428)	(154,847)
Cash flows from financing activities:			
Proceeds from borrowings of convertible senior notes, net of issuance costs	—	—	291,897
Proceeds from issuance of warrants	—	—	43,560
Purchase of convertible note hedge	—	—	(63,510)
Proceeds from issuance of common stock upon exercise of stock options	3,221	3,243	19,112
Repurchases of common stock	(179,090)	(88,815)	(32,241)
Prepayment of accelerated share repurchase	(75,000)	—	—
Refund of accelerated share repurchase	38,179	—	—
Excess tax benefits from stock-based compensation	1,813	1,025	3,635
Principal payments of capital lease and financing obligations	(12,723)	(3,054)	(878)
Net cash provided by/(used in) financing activities	(223,600)	(87,601)	261,575
Net increase/(decrease in) cash and cash equivalents	(91,680)	(118,541)	253,996
Cash and cash equivalents, beginning of period	380,543	499,084	245,088

Cash and cash equivalents, end of period	$288,863	$380,543	$499,084

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

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SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2015	2014	2013
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	$6,256	$1,133	$466
Income taxes	1,056	667	2,158
Supplemental schedule of non-cash investing / financing activities:			
Net increase/(decrease) in accrued purchases of property and equipment	$3,818	$(2,674)	$(3,372)
Net increase in accrued capitalized software and website development costs	892	716	—
Stock-based compensation capitalized with software and website development costs	1,247	1,597	1,709
Increase in estimated fair market value of buildings under build-to-suit leases	17,161	22,855	10,080
Property and equipment acquired under capital leases	29,097	37,823	—
Increase to amount due for acquisition of business	—	1,673	—
Amount due from adjustment of net working capital from acquired business	—	253	10

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

SHUTTERFLY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Description of Business

Shutterfly, Inc., (the "Company" or "Shutterfly") was incorporated in the state of Delaware in 1999 and began its services in December 1999. The Company is the leading manufacturer and digital retailer of high-quality personalized products and services offered through a family of lifestyle brands. The Company provides customers a full range of products and services to organize and archive digital images; share pictures; order prints and create an assortment of personalized items such as photo books, greeting cards and stationery and calendars. Shutterfly also operates a premier online marketplace for high-quality photographic and video equipment rentals. And the Company provides Enterprise services: printing and shipping of direct marketing and other variable data print products and formats. The Company is headquartered in Redwood City, California.

Note 2 — The Company and Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The functional currency of its Israeli subsidiary is the U.S. Dollar, as such, exchange rate fluctuations are recorded as a part of earnings. All intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Items subject to such estimates and assumptions include, among others, intangible assets valuation, useful lives, excess and obsolete inventories, restructuring, legal contingencies, valuation allowances, restricted stock awards with market criteria, provision for sales returns, flash deal deferred revenue breakage, and allowance for doubtful accounts. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. Management determines the appropriate classification of cash equivalents at the time of purchase and reevaluates such designations at each balance sheet date. Cash equivalents consist of money market funds, primarily invested in U.S. Treasury securities.

Fair Value

The Company records its financial assets and liabilities at fair value. The accounting standard for fair value provides a framework for measuring fair value, clarifies the definition of fair value, and expands disclosures regarding fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The accounting standard establishes a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Investments

Investments, which may include agency bonds, corporate debt securities, and U.S. government securities, are classified as available-for-sale and are reported at fair value using the specific identification method. Unrealized gains and losses are excluded from earnings and reported as a component of other comprehensive income (loss), net of related estimated tax provisions or benefits. Investments whose maturity dates are less than twelve months are classified as short-term, and those with maturity dates greater than twelve months are classified as long-term.

The Company assesses whether an other-than-temporary impairment loss on its investments has occurred due to declines in fair value or other market conditions. With respect to the Company's debt securities, this assessment takes into account the severity and duration of the decline in value, its intent to sell the security, whether it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, and whether it expects to recover the entire amortized cost basis of the security (that is, whether a credit loss exists). The Company did not recognize an other-than-temporary impairment loss on its investments in the year ended December 31, 2015.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist principally of cash, cash equivalents, investments, and accounts receivable. As of December 31, 2015, the Company's cash and cash equivalents were maintained by financial institutions in the United States and its deposits may be in excess of insured limits. The Company believes that the financial institutions that hold its investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The Company’s accounts receivable are derived primarily from sales to customers located in the United States who make payments through credit cards, sales of the Company's products in sales of Enterprise services and revenue generated from online advertisements posted on the Company's websites. Credit card receivables settle relatively quickly and the Company's historical experience of credit card losses have not been material and have been within management’s expectations. Excluding amounts due from credit cards of customers, as of December 31, 2015, two Enterprise customers accounted for 51% and 12% of the Company’s net accounts receivable, respectively. No other customers accounted for more than 10% of net accounts receivable as of December 31, 2015. As of December 31, 2014, excluding amounts due from credit cards of customers, two Enterprise customers accounted for 25% and 18% of the Company’s net accounts receivable. No other customers accounted for more than 10% of net accounts receivable as of December 31, 2014. No customers accounted for more than 10% of net revenues in the years ended December 31, 2015 and 2014.

Inventories

Inventories are stated at the lower of cost on a first-in, first-out basis or net realizable value. The value of inventories is reduced by estimates for excess and obsolete inventories. The estimate for excess and obsolete inventories is based upon management’s review of utilization of inventories in light of projected sales, current market conditions and market trends. Inventories are primarily raw materials and consist principally of paper, photo book covers and packaging supplies.

Deferred Costs

Deferred costs are the incremental costs directly associated with flash deal promotions through group buying websites. These costs are paid and deferred at the time of the flash deal, and recognized when the redeemed products are shipped or flash deal deferred revenue breakage has been recognized. Amortization of deferred costs is included in sales and marketing expense in the accompanying consolidated statements of operations.

Property and Equipment

Property and equipment are stated at historical cost, less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated lives of the assets, generally three to five years, and are allocated between cost of net revenues and operating expenses. Rental assets are depreciated over their estimated useful lives, generally five to six years as component of cost of net revenues, to an estimated net realizable value. Leasehold improvements are amortized over their estimated useful lives, or the lease term if shorter, generally three to ten years. Upon retirement or sale, the cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operating expenses, except for rental assets, which are recognized in cost of net revenues. Major additions and improvements are capitalized, while replacements, maintenance and repairs that do not extend the life of the asset are charged to expense as incurred.

Software and Website Development Costs

The Company capitalizes eligible costs associated with website development and software developed or obtained for internal use. Accordingly, the Company expenses all costs that relate to the planning and post implementation phases. Payroll and payroll related costs and stock-based compensation incurred in the development phase are capitalized and amortized over the product's estimated useful life, generally three years. Costs associated with minor enhancements and maintenance for the Company's websites are expensed as incurred.

Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by comparison of the carrying amount to the future net cash flows which the assets are expected to generate. 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 projected discounted future cash flows arising from the asset using a discount rate determined by management to be commensurate with the risk inherent to the Company's current business model.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Intangible assets resulting from the acquisition of entities accounted for using the purchase method of accounting are estimated by management based on the fair value of assets received. Intangible assets are amortized on a straight-line basis over the estimated useful lives which range from one to sixteen years, and the amortization is allocated between cost of net revenues and operating expenses. Goodwill and intangible assets with indefinite lives are not subject to amortization, but are tested for impairment on an annual basis during the fourth quarter or whenever events or changes in circumstances indicate the carrying amount of these assets may not be recoverable.

For the Company's annual goodwill impairment analysis, the Company operates under two reporting units. As part of the annual goodwill impairment test, the Company first performs a qualitative assessment to determine whether further impairment testing is necessary. If, as a result of its qualitative assessment, it is more-likely-than-not (i.e. greater than 50% chance) that the fair value of the Company's reporting units are less than its carrying amounts, the quantitative impairment test will be required. Otherwise, no further testing will be required.

If is its determined, as a result of the qualitative assessment, that it is more-likely-than not that the fair value of the Company's reporting unit is less than its carrying amount, the provisions of authoritative guidance require that the Company perform a two-step impairment test on goodwill. The Company tests goodwill for impairment by first comparing the book value of net assets to the fair value of the reporting units. If the fair value is determined to be less than the book value or qualitative factors indicate that it is more likely than not that goodwill is impaired, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value. The Company estimates the fair value of the reporting units using a combination of the income approach (discounted cash flows) and the market approach. Forecasts of future cash flows are based on our best estimate of future net sales and operating expenses, based primarily on expected reporting unit expansion, pricing, market segment share, and general economic conditions.

Intellectual Property Prepaid Royalties

The Company has patent license agreements with various third parties. The Company has accounted for these agreements as prepaid royalties that are amortized over the remaining life of the patents. Amortization expense is recorded on a straight-line basis as a component of cost of revenue. The current portion of the prepaid royalty is recorded as a component of prepaid expenses and the long term portion is recorded in other assets.

Lease Obligations

The Company categorizes leases at their inception as either operating or capital leases. On certain of our lease agreements, the Company may receive rent holidays and other incentives. The Company recognizes lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays that defer the commencement date of required payments. Additionally, incentives the Company receives for leases categorized as operating leases are treated as a reduction of our costs over the term of the agreement.

The Company establishes assets and liabilities for the estimated construction costs incurred under build-to-suit lease arrangements to the extent the Company is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease. Upon occupancy of facilities under build-to-suit leases, the Company assesses whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance. If the Company continues to be the deemed owner, the facilities are accounted for as financing leases.

Revenue Recognition

The Company recognizes revenue from Consumer and Enterprise product sales, net of applicable sales tax, upon shipment of fulfilled orders, when persuasive evidence of an arrangement exists, the selling price is fixed or determinable and collection of resulting receivables is reasonably assured. Customers place Consumer product orders through the Company's websites and pay primarily using credit cards. Enterprise customers are invoiced upon fulfillment. Shipping charged to customers is recognized as revenue at the time of shipment.

For camera, lenses, and video equipment rentals from our BorrowLenses brand, we recognize rental revenue and the related shipping and insurance revenue, ratably over the rental period. Revenue from the sale of rental equipment is recognized upon shipment of the equipment.

For gift card sales and flash deal promotions through group buying websites, the Company recognizes revenue on a gross basis, as it is the primary obligor, when redeemed items are shipped. Revenues from sales of prepaid orders on its websites are deferred until shipment of fulfilled orders or until the prepaid period expires. The Company’s share of revenue generated from its print to retail relationships, is recognized when orders are picked up by its customers at the respective retailer.

In the second quarter of 2015, the Company changed its accounting estimate related to flash deal deferred revenue. Beginning in 2010, the Company began to market product offers on flash deal websites such as Groupon and LivingSocial. With limited history as to customer redemption patterns, the Company had been deferring all amounts to a flash deal deferred revenue liability until customer redemption. The Company now has sufficient relevant historical flash deal redemption data to support a change in estimate of the flash deal deferred revenue based on historical customer redemption patterns. The historical data supports the probability of redemption after two years from the issuance of a flash deal offer as remote. In addition, the Company's attempts to re-market the unredeemed flash deals over the last six months resulted in no meaningful change in customer behavior. Accordingly, flash deal breakage revenue is now recognized based upon its historical redemption patterns and represents the unredeemed flash deal offers for which the Company believes customer redemption is remote and it is not probable that the Company has an obligation to escheat the value of the flash deal revenue under unclaimed property laws. During the year ended December 31, 2015, the Company recognized revenue of $10.0 million associated with this change.

The Company provides its customers with a 100% satisfaction guarantee whereby products can be returned within a 30-day period for a reprint or refund. The Company maintains an allowance for estimated future returns based on historical data. The provision for estimated returns is included in accrued expenses.

The Company periodically provides incentive offers to its customers in exchange for setting up an account and to encourage purchases. Such offers include free products and percentage discounts on current purchases. Discounts, when accepted by customers, are treated as a reduction to the purchase price of the related transaction and are presented in net revenues. Production costs related to free products are included in cost of revenues upon redemption.

The Company’s advertising revenues are derived from the sale of online advertisements on its websites. Advertising revenues are recognized as “impressions” (i.e., the number of times that an advertisement appears in pages viewed by users of the Company's websites) are delivered; as “clicks” (which are generated each time users of the Company's websites click through the advertisements to an advertiser’s designated website) are provided to advertisers; or ratably over the term of the agreement with the expectation that the advertisement will be delivered ratably over the contract period.

Certain Enterprise revenue arrangements with multiple deliverables, including products and services, are divided into separate units and revenue is allocated using estimated selling prices if we do not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables. The Company allocated the arrangement price to each of the elements based on the relative selling prices of each element. Estimated selling prices are management’s best estimates of the prices that the Company would charge our customers if the Company were to sell the standalone elements separately and include considerations of customer demand, prices charged by the Company and others for similar deliverables, and the price if largely based on the cost of producing the product or service. For up-front fees the Company received in exchange for products delivered or services performed, it is deferred and recognized over periods that the fees are earned. In cases in which an up-front fee is not related to specific products or services, the fee is excluded from the consideration that is allocated to the deliverables, and be recognized over the longer of the initial contractual term of the arrangement or the estimated period the customer is expected to benefit from the payment of the up-front fee.

Restructuring Costs

The Company records restructuring costs when expenses are incurred. The Company accrues for lease termination costs when the restructuring event takes place. The Company accrues for severance once the total severance pool has been calculated, approved and communicated, and recognizes the expense ratably over the required service period, from the communication date to the exit date. The Company also accelerates depreciation using a revised economic life of the leasehold improvement assets.

Advertising Costs

Advertising costs are expensed as incurred, except for direct mail advertising which is expensed when the advertising first takes place. The Company did not have any capitalized direct mail costs at December 31, 2015 and December 31, 2014. Total advertising costs are a component of sales and marketing expenses and include print advertising, Internet advertising, such as display ads and keyword search terms and TV and radio advertising. These amounts totaled approximately $117.1 million, $102.2 million and $87.5 million during the years ended December 31, 2015, 2014 and 2013, respectively.

Stock-Based Compensation

The Company measures stock based awards at fair value and recognizes compensation expense for all share-based payment awards made to its employees and directors, including employee stock options and restricted stock awards.

The Company estimates the fair value of stock options granted using the Black-Scholes valuation model. This model requires the Company to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of the Company's common stock price and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in the Company's consolidated statements of operations. The Company has not issued any stock options since the first quarter of 2013.

The cost of restricted stock awards and performance based restricted stock awards is determined using the fair value of the Company’s common stock on the date of grant. Compensation expense is recognized for restricted stock awards on a straight-line basis over the vesting period. Compensation expense associated with performance based restricted stock awards is recognized on an accelerated attribution model, and ultimately based on whether or not satisfaction of the performance criteria is probable. If in the future, situations indicate that the performance criteria are not probable, then no further compensation cost will be recorded, and any previous costs will be reversed. The cost of restricted stock awards with market conditions is estimated using a Monte Carlo valuation model.

Employee stock-based compensation expense is calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized by applying the statutory tax rates in effect in the years in which the differences between the financial reporting and tax filing bases of existing assets and liabilities are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

The Company reports a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. The Company is required to make subjective assumptions and judgments regarding its income tax exposures. Interpretations and guidance surrounding income tax laws and regulations change over time. As such, changes in the Company’s subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of operations.

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The Company’s policy is to recognize interest and /or penalties related to all tax positions in income tax expense. To the extent that accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision in the period that such determination is made. No interest and penalties were accrued as of December 31, 2015 and 2014.

The Company is subject to taxation in the United States and Israel.

Net Income/(Loss) Per Share

Basic net income/(loss) per share attributed to common shares is computed by dividing the net income/(loss) attributable to common shares for the period by the weighted average number of common shares outstanding during the period.

Diluted net income/(loss) per share attributed to common shares is computed by dividing the net income attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period, if the effect of each class of potential common shares is dilutive. Potential common shares include restricted stock units and incremental shares of common stock issuable upon the exercise of stock options, conversion of warrants, and the impact of convertible debt.

	Year ended December 31,		
	2015	2014	2013
Net income/(loss) per share:	(in thousands, except per share amounts)		
Numerator			
Net income/(loss)	$(843)	$(7,860)	$9,285
Denominator			
Denominator for basic net income/(loss) per share			
Weighted-average common shares outstanding	36,761	38,452	37,680
Dilutive effect of stock options and restricted awards	—	—	1,813
Denominator for diluted net income per share	36,761	38,452	39,493
Net income/(loss) per share			
Basic	$(0.02)	$(0.20)	$0.25
Diluted	$(0.02)	$(0.20)	$0.24

The following weighted-average outstanding stock options and restricted stock units were excluded from the computation of diluted net income/(loss) per common share for the periods presented because including them would have had an anti-dilutive effect (in thousands):

	Year ended December 31,		
	2015	2014	2013
Stock options and restricted stock units	4,185	4,205	24

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income is composed of net income/(loss) and other comprehensive income/(loss). The Company's other comprehensive income/(loss) consists of unrealized gains and losses on marketable securities classified as available-for-sale.

Segment Reporting

The Company reports as two operating segments with the Chief Executive Officer ("CEO") acting as the Company's chief operating decision maker. The Company defined two reportable segments based on factors such as how management manages the operations and how its chief operating decision maker views results. The Company has the following reportable segments:

Consumer - Includes sales from the Company's brands and are derived from the sale of photo-based products, such as photo books, stationery and greeting cards, other photo-based merchandise, photo prints, and the related shipping revenues as well as rental revenue from its BorrowLenses brand.
Enterprise - Includes revenues primarily from variable, four-color direct marketing collateral manufactured and fulfilled for business customers.

In addition to the above reportable segments, the Company has a corporate category that includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation and amortization of intangible assets.

Recent Accounting Pronouncements

In May 2014, the Financial Accountings Standards Board ("FASB") issued new accounting guidance related to revenue recognition. This new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for the Company beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the impact, if any, of adopting this new accounting guidance on its financial statements.

In August 2014, the FASB issued new guidance related to the disclosures around going concern. The new standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's financial statements.

In April 2015, the FASB issued new guidance related to presentation of debt issue costs. The new standard requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The adoption of this guidance will be effective for the Company beginning January 1, 2016, and is not expected to have a material impact on its financial statements.

In April 2015, the FASB issued new guidance related to accounting for fees paid in a cloud computing arrangement. The new standard provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The Company is evaluating the impact, if any, of adopting this new accounting guidance on its financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory - Simplifying the Measurement of Inventory (Topic 330). ASU 2015-11 requires inventory to be subsequently measured using the lower of cost and net realizable value, thereby eliminating the market value approach. Net realizable value is defined as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation.” ASU 2015-11 is effective for reporting periods beginning after December 15, 2016 and is applied prospectively. Early adoption is permitted. The Company is evaluating the impact, if any, of adopting this new accounting guidance on its financial statements.

In September 2015, the FASB issued new guidance related to business combinations. The new guidance requires that adjustments made to provisional amounts recognized in a business combination be recorded in the period such adjustments are determined, rather than retrospectively adjusting previously reported amounts. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is evaluating the impact, if any, of adopting this new accounting guidance on its consolidated financial statements.

In November 2015, the FASB issued new ASU 2015-17, Balance Sheet Classification of Deferred Taxes (ASU 2015-17). The ASU is part of the Boards simplification initiative aimed at reducing complexity in accounting standards. The new guidance may impact balance sheet presentation and working capital for many reporting entities, even in cases where there is a full valuation allowance. ASU 2015-11 is effective for reporting periods beginning after December 15, 2016 and is applied either prospectively or retrospectively. Early adoption is permitted. The Company early adopted ASU 2015-17 effective December 31, 2015 on a

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prospective basis. Adoption of this ASU resulted in a reclassification of our net current deferred tax asset to the net non-current deferred liability in our consolidated balance sheet as of December 31, 2015. No prior periods were retrospectively adjusted.

Note 3 — Balance Sheet Components

Intellectual Property Prepaid Royalties

Total amortization for these license agreements in 2015 and 2014 were $1.3 million and $1.6 million, respectively. As of December 31, 2015, the Company had a balance of $7.3 million in unamortized prepaid royalties. Amortization of these licenses is estimated as follows (in thousands):

Year Ending:	
2016	$1,182
2017	799
2018	799
2019	675
2020	503
Thereafter	3,359
	$7,317

Prepaid Expenses and Other Current Assets

	December 31,	
	2015	2014
	(in thousands)	
Prepaid service contracts – current portion	$12,539	$6,754
Deferred costs	3,849	6,911
Prepaid postage	3,047	1,492
Rebates	3,004	3,164
Prepaid marketing	1,197	446
Other prepaid expenses and current assets	9,511	6,216
	$33,147	$24,983

Other Assets

	December 31,	
	2015	2014
	(in thousands)	
Other assets	$11,176	$13,976

Other assets includes the long-term portion of intellectual property prepaid royalties, the long-term portion of issuance costs related to the Company's 0.25% Convertible Notes, the long-term portion of prepaid service contracts, and deposits on long-term leases and other contracts.

Property and Equipment

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	December 31, 2015	2014
	(in thousands)	
Computer equipment and software	$172,048	$159,370
Manufacturing equipment	148,820	119,495
Capitalized software and website development costs	108,837	89,311
Buildings under build-to-suit leases	56,468	39,307
Leasehold improvements	21,519	20,876
Rental equipment	17,414	14,591
Furniture and fixtures	11,351	10,683
	536,457	453,633
Less: Accumulated depreciation and amortization	(254,678)	(211,891)
Net property and equipment	$281,779	$241,742

Building value of $56.5 million under build-to-suit leases represents the estimated fair market value of buildings under build-to-suit leases of which the Company is the "deemed owner" for accounting purposes only. See Note 7 - Commitments and Contingencies for further discussion of the Company's build-to-suit leases.

Included within Manufacturing equipment is approximately $72.9 million and $44.2 million of capital lease obligations for various pieces of manufacturing facility equipment in 2015 and 2014, respectively. Accumulated depreciation of assets under capital lease totaled $14.1 million at December 31, 2015 compared to $3.1 million at December 31, 2014.

Rental equipment includes camera lenses, camera bodies, video equipment and other camera peripherals which are rented through the BorrowLenses' website.

Depreciation and amortization expense totaled $86.3 million, $64.9 million, and $43.9 million for the years ended December 31, 2015, 2014 and 2013, respectively.

Total capitalized software and website development costs, net of accumulated amortization totaled $38.4 million and $35.7 million at December 31, 2015 and 2014, respectively. Amortization of capitalized costs totaled approximately $18.7 million, $14.9 million and $10.8 million for the years ended December 31, 2015, 2014 and 2013, respectively.

Intangible Assets

Intangible assets are comprised of the following:

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	Weighted Average Useful Life	December 31, 2015	2014
		(in thousands)	
Purchased technology	10 years	$104,869	$104,738
Less: accumulated amortization		(62,011)	(51,794)
		42,858	52,944
Customer relationships	5 years	75,146	75,146
Less: accumulated amortization		(56,756)	(42,086)
		18,390	33,060
Licenses and other	3 years	7,202	7,202
Less: accumulated amortization		(6,127)	(5,256)
		1,075	1,946
Total		$62,323	$87,950

Purchased technology is amortized over a period ranging from one to sixteen years. Customer relationships are amortized over a period ranging from one to seven years. Licenses and other is amortized over a period ranging from two to five years.

Intangible asset amortization expense for the years ended December 31, 2015, 2014 and 2013 was $25.8 million, $32.3 million and $29.5 million, respectively. Amortization of existing intangible assets is estimated to be as follows (in thousands):

Year Ending:	
2016	$18,903
2017	13,743
2018	4,835
2019	3,408
2020	3,407
Thereafter	18,027
	$62,323

Goodwill

In the fourth quarter of 2014, the Company reassessed its reportable segments. As part of this review, the Company determined that it had two reporting units; and that those two reporting units are also reportable segments. Refer to Note 13 - Segment Reporting of the financial statements for discussion of these two segments. The Company allocated goodwill to each reporting unit based on their relative fair values.

The Company conducted its annual qualitative assessment (Step Zero Analysis) test as of December 31, 2015 to determine whether it would be necessary to perform the two-step goodwill impairment test. Among other things, the Company considered the i) excess in fair value of the reporting unit over its carrying amount from the most recent step one calculation, ii) macroeconomic conditions, iii) industry and market trends, and iv) overall financial performance. The Company determined based on the Step Zero Analysis that it is more likely than not that the fair value of the reporting units exceeded their carrying amounts.

The Company performed step one of the annual goodwill impairment test for the year ended December 31, 2014. The Enterprise value exceeded the carrying value for both periods and accordingly, no impairment was recorded.

The following table presents goodwill balances and adjustments to those balances for each of our reportable segments (in thousands):

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	Consumer	Enterprise	Corporate	Total
Balance, December 31, 2013	$—	$—	$397,306	$397,306
Acquisition of business	—	—	12,033	12,033
Goodwill adjustments	—	—	(364)	(364)
Goodwill allocation	372,072	36,903	(408,975)	—
Balance, December 31, 2014	372,072	36,903	—	408,975
Acquisition of business	—	—	—	—
Goodwill adjustments	—	—	—	—
Balance, December 31, 2015	$372,072	$36,903	$—	$408,975

For the year ended December 31, 2014, adjustments to goodwill reflected final adjustments to net working capital acquired under provisions of certain business combination purchase agreements. There were no adjustments to goodwill for the year ended December 31, 2015.

Accrued Liabilities

	December 31, 2015	2014
	(in thousands)	
Accrued production costs	$44,825	$32,814
Accrued marketing expenses	26,793	30,835
Accrued compensation	20,703	16,337
Accrued income and sales tax	17,843	18,149
Capital lease obligations	14,090	8,905
Accrued purchases	6,651	11,809
Accrued consulting	5,872	6,418
Accrued other	12,357	10,218
	$149,134	$135,485

Other Liabilities

	December 31, 2015	2014
	(in thousands)	
Financing obligations	$56,771	$38,529
Capital lease obligations	44,428	32,297
Deferred revenue	6,564	—
Other liabilities	2,902	3,352
	$110,665	$74,178

Financing obligations relate to the Company's build-to-suit leases as further discussed in Note 7 - Commitments and Contingencies.

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Note 4 — Investments

At December 31, 2015 and 2014, the estimated fair value of short-term and long-term investments classified as available for sale are as follows (in thousands):

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments				
Corporate debt securities	$16,187	$2	$(14)	$16,175
Agency securities	6,246	—	(2)	6,244
Commercial paper	499	—	—	499
Total short-term investments	$22,932	$2	$(16)	$22,918
Long-term investments				
Corporate debt securities	$10,132	$—	$(37)	$10,095
Agency securities	13,421	1	(43)	13,379
US Government securities	5,549	—	(18)	5,531
Total long-term investments	$29,102	$1	$(98)	$29,005

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments				
Corporate debt securities	$64,922	$3	$(59)	$64,866
Agency securities	—	—	—	—
Total short-term investments	$64,922	$3	$(59)	$64,866
Long-term investments				
Corporate debt securities	$14,511	$1	$(30)	$14,482
Agency securities	13,649	3	(7)	13,645
US Government securities	1,799	2	—	1,801
Total long-term investments	$29,959	$6	$(37)	$29,928

The Company had no short-term or long-term investments that have been in a continuous unrealized loss position for more than 12 months as of December 31, 2015 and 2014 and no impairments were recorded in the period. The Company had no material realized gains or losses during the years ended December 31, 2015 and 2014.

The following table summarizes the contractual maturities of the Company's investments as of December 31, 2015 and 2014(in thousands):

	December 31,	
	2015	2014
One year or less	$22,918	$64,866
One year through three years	29,005	29,928
	$51,923	$94,794

Actual maturities may differ from the contractual maturities because borrowers may have certain prepayment conditions.

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Note 5 — Fair Value Measurement

Cash Equivalents and Investments

The Company measures the fair value of money market funds and investments based on quoted prices in active markets for identical assets or liabilities. All other financial instruments were valued either based on recent trades of securities in inactive markets or based on quoted market prices of similar instruments and other significant inputs derived from or corroborated by observable market data. The Company did not hold any cash equivalents or investments categorized as Level 3 as of December 31, 2015.

The following table summarizes, by major security type, the Company's cash equivalents and investments that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy (in thousands):

	Total Estimated Fair Value as of	
	December 31, 2015	December 31, 2014
Level 1 Securities:		
Money market funds	$24,577	$34,480
Level 2 Securities:		
Agency securities	19,621	13,645
Corporate debt securities	27,122	79,348
US Government securities	5,531	1,801
Commercial Paper	499	—
Total cash equivalents and investments	$77,350	$129,274

Convertible Senior Notes

As of December 31, 2015 and 2014, the fair value of the convertible senior notes, which was determined based on inputs that are observable in the market or that could be derived from, or corroborated with, observable market data, including our stock price, interest rates and credit spread (Level 2) were as follows (in thousands):

	Total Estimated Fair Value as of	
	December 31, 2015	December 31, 2014
Convertible senior notes	$270,192	$251,973

The carrying value of other financial instruments, including accounts receivable, accounts payable and other payables, approximates fair value due to their short maturities.

Note 6 — Acquisitions

Business Combinations

Dot Copy, Inc. ("Groovebook")
On October 31, 2014, the Company acquired certain assets of Dot Copy, Inc. ("Groovebook") for a total aggregate purchase price of $13.7 million, consisting of an upfront cash purchase amount and a future performance-based earn-out subject to achieving certain financial metrics. Groovebook is a mobile photo book app subscription service that sends customers a keepsake book of their mobile photos each month. The acquisition was accounted for as a

purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill.

Of the total purchase price, $0.6 million was allocated to the customer base, which will be amortized over an estimated useful life of two years, $0.5 million was allocated to the Groovebook tradename, which will be amortized over an estimated useful life of three years, $0.4 million was allocated to Groovebook patents, which will be amortized over an estimated useful life of two years and $0.2 million was allocated to developed technologies, which will be amortized over an estimated useful life of one year. The remaining excess purchase price of approximately $12.0 million was allocated to goodwill primarily representing manufacturing and production synergies and synergies from Groovebooks' market position. The results of operations for the acquired business have been included in the consolidated statement of operations for the period subsequent to the Company's acquisition of Groovebook. Groovebook's results of operations for periods prior to this acquisition were not material to the consolidated statement of operations and, accordingly, pro forma financial information has not been presented.

BorrowLenses LLC
On October 24, 2013, the Company acquired BorrowLenses LLC ("BorrowLenses") for a total aggregate cash purchase price of $36.8 million, or $35.7 million net of cash acquired. BorrowLenses is a premier online marketplace for photographic and video equipment rentals. The acquisition was accounted for as a non-taxable purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill. For federal income tax purposes, an election was made to treat the non-taxable transaction as an asset acquisition.

Of the total purchase price, $4.2 million was allocated to the customer base, which will be amortized over an estimated useful life of four years, $1.0 million was allocated to developed technologies, which will be amortized over an estimated useful life of approximately three years, and $1.6 million was allocated to the BorrowLenses tradename, which will be amortized over an estimated useful life of four years. The assets and liabilities acquired totaled approximately $13.3 million and $0.8 million, respectively. The remaining excess purchase price of approximately $17.6 million was allocated to goodwill primarily representing the assembled workforce and synergies from BorrowLenses' market position. The results of operations for the acquired business have been included in the consolidated statement of operations for the period subsequent to the Company's acquisition of BorrowLenses. BorrowLenses' results of operations for periods prior to this acquisition were not material to the consolidated statement of operations and, accordingly, pro forma financial information has not been presented.

R&R Images, Inc.
On August 29, 2013, the Company acquired certain assets of R&R Images, Inc. ("R&R") primarily to expand product innovation and printing capabilities. The acquisition was accounted for as a business combination. This acquisition was not significant individually or when aggregated with other acquisitions during the year ended December 31, 2013. The Company has included financial results of R&R in the consolidated financial statements from the acquisition date of August 29, 2013 through December 31, 2013.

MyPublisher, Inc.
On April 29, 2013, the Company acquired MyPublisher, Inc. ("MyPublisher") for a total aggregate cash purchase price of $40.2 million, or $38.4 million net of cash acquired. MyPublisher is one of the pioneers in the photo book industry and creator of easy-to-use photo book making software. The acquisition was accounted for as a non-taxable purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill.

Of the total purchase price, $9.5 million was allocated to the customer base, which will be amortized over an estimated useful life of four years, $7.8 million was allocated to developed technologies and will be amortized over an estimated useful life of approximately two years, $1.3 million to the MyPublisher tradename, which will be amortized over an estimated useful life of two years, and $0.1 million to favorable leases which will be amortized over an estimated useful life of five years. The tangible assets and liabilities acquired totaled approximately $8.2 million and $7.8 million, respectively. Included within assets and liabilities is a net deferred tax liability of approximately $0.3 million representing the difference between the assigned values of the assets acquired and the tax basis of those assets, with the offset recorded as additional goodwill. The remaining excess purchase price of approximately $21.1 million was allocated to goodwill primarily representing the assembled workforce and synergies from MyPublisher's market position. The results of operations for the acquired business have been included in the consolidated statement of operations for the period subsequent to the Company's acquisition of MyPublisher. MyPublisher's results of operations for periods prior to this acquisition were not material to the consolidated statement of operations and, accordingly, pro forma financial information has not been presented.

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Note 7 — Commitments and Contingencies

Leases

The Company leases office and production space under various non-cancelable operating leases that expire no later than January 2023. Rent expense was $9.7 million, $7.2 million and $5.8 million, for the years ended December 31, 2015, 2014 and 2013, respectively.

Rent expense is recorded on a straight-line basis over the lease term. When a lease provides for fixed escalations of the minimum rental payments, the difference between the straight-line rent charged to expense, and the amount payable under the lease is recognized as deferred rent.

The Company has non-cancelable operating leases for certain production equipment with terms ranging from one to three years. As of December 31, 2015, the total outstanding obligation under all equipment operating leases was $9.0 million.

The Company also has production equipment under capital lease. During the year ended December 31, 2015, the Company modified certain existing equipment lease agreements which resulted in the leases being reclassified from operating to capital leases. The Company also entered into new equipment leases with terms which resulted in capital lease treatment.

At December 31, 2015, the total future minimum payments under non-cancelable operating and capital leases are as follows (in thousands):

	Operating Leases	Capital Leases
Year Ending:		
2016	$8,606	$16,147
2017	6,939	15,879
2018	3,316	15,044
2019	1,120	11,214
2020	814	3,957
Thereafter	1,752	1,487
Total minimum lease payments	$22,547	$63,728
Less: amount representing interest		(5,210)
Present value of future minimum lease payments		58,518
Less: current portion		(14,090)
Non-current portion of capital lease obligations		$44,428

Purchase obligations consist of non-cancelable marketing and service agreements and co-location services that expire at various dates through the year 2020. As of December 31, 2015, the Company's purchase obligations totaled $88.8 million. At December 31, 2015, the total future minimum payments under these purchase obligations are as follows (in thousands):

Year Ending:	
2016	$24,131
2017	21,434
2018	16,558

2019	15,346
2020	11,334
Thereafter	—
Total minimum purchase obligations	$88,803

Build-to-suit Lease

During the year ended December 31, 2012, the Company executed a lease for a 300,000 square foot east coast production and customer service facility in Fort Mill, South Carolina. This facility replaced the Company's current east coast production facility in Charlotte, North Carolina. In order for the facility to meet the Company's operating specifications, both the landlord and the Company made structural changes as part of the uplift of the building, and as a result, the Company has concluded that it was the “deemed owner” of the building (for accounting purposes only) during the construction period. Accordingly, at lease inception, the Company recorded an asset of $4.9 million, representing its estimate of the fair market value of the building, and a corresponding construction financing obligation, recorded as a component of other non-current liabilities. The Company increased the asset and financing obligations by $3.1 million and $1.5 million for building uplift costs incurred by the landlord during 2013 and 2012, respectively.

During the year ended December 31, 2013, the Company executed a lease for a 217,000 square foot production facility in Shakopee, Minnesota. This facility provides additional production capacity. Both the landlord and the Company incurred costs to construct the facility according to the Company's operating specifications, and as a result, the Company has concluded that it was the “deemed owner” of the building (for accounting purposes only) during the construction period. Accordingly, the Company recorded an asset and corresponding construction financing obligation, as a component of non-current liabilities, of $13.7 million and $7.0 million for building uplift costs incurred by the landlord during 2014 and 2013, respectively.

Also during the year ended December 31, 2013 the Company executed a lease for a 237,000 square foot production facility in Tempe, Arizona. This facility consolidated all of the Company's locations in the greater Phoenix area, including the acquired R&R Images facility, offers flexibility for future expansion, and became operational in the second quarter of 2015. Both the landlord and the Company incurred costs to construct the facility according to the Company's operating specifications, and as a result, the Company has concluded that it is the “deemed owner” of the building (for accounting purposes only) during the construction period. As of December 31, 2015 and 2014, the landlord incurred $17.2 million and $9.1 million of building construction costs which the Company has recorded as an asset, with a corresponding construction financing obligation, which is recorded as a component of other non-current liabilities.

Upon completion of construction of these facilities, the Company evaluates the de-recognition of the asset and liability under the provisions of ASC 840.40 Leases - Sale-Leaseback Transactions. However, if the Company does not comply with the provisions needed for sale-leaseback accounting, the lease will be accounted for as a financing obligation and lease payments will be attributed to (1) a reduction of the principal financing obligation; (2) imputed interest expense; and (3) land lease expense (which is considered an operating lease and a component of cost of goods sold) representing an imputed cost to lease the underlying land of the facility. In addition, the underlying building asset will be depreciated over the building's estimated useful life which is generally 30 years. And at the conclusion of the lease term, the Company would de-recognize both the net book values of the asset and financing obligation. Construction of the facilities in Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona were completed in 2013, 2014, and 2015, respectfully, and at that time the Company concluded that it had forms of continued economic involvement in the facilities. As a result, the Company did not comply with provisions for sale-leaseback accounting and the buildings are being accounted for as a financing obligation.

At December 31, 2015, the total future rent payments under these build-to-suit leases are as follows (in thousands):

Year Ending:

2016	$6,082
2017	6,218
2018	6,358
2019	6,501
2020	6,646
Thereafter	26,742
Total future rent payments under build-to-suit leases	$58,547

Indemnifications

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because it involves future claims that may be made against the Company, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations.

Contingencies

From time to time, the Company may have certain contingent liabilities that arise in the ordinary course of its business activities. The Company accrues contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated.

Syndicated Credit Facility

On November 22, 2011, the Company entered into a credit agreement ("Credit Agreement") with J.P. Morgan Securities LLC, Wells Fargo Securities, LLC, Fifth Third Bank, Silicon Valley Bank, US Bank and Citibank, N.A. ("the Banks"). JPMorgan Chase Bank, N.A. acted as administrative agent in the Credit Agreement. The Credit Agreement is for five years and provides for a $125.0 million senior secured revolving credit facility (the "credit facility") and if requested by the Company, the Banks may increase the credit facility by $75.0 million subject to certain conditions. In December 2013, the Company requested and received the entire incremental amount for a total credit facility of $200.0 million. As part of the expansion, Bank of America, N.A. and Morgan Stanley Bank, N.A. joined the syndicate. From inception through December 31, 2015, the Company has not drawn on the credit facility.

At the Company's option, loans under the Facility will bear stated interest based on the Base Rate or Adjusted LIBO Rate, in each case plus the Applicable Rate (respectively, as defined in the Credit Agreement). The Base Rate will be, for any day, the highest of (a) 1/2 of 1% per annum above the Federal Funds Effective Rate (as defined in the Credit Agreement), (b) JPMorgan Chase Bank's prime rate and (c) the Adjusted LIBO Rate for a term of one month plus 1.00%. Eurodollar borrowings may be for one, two, three or six months (or such period that is 12 months or less, requested by Intersil and consented to by all the Lenders) and will be at an annual rate equal to the period-applicable Eurodollar Rate plus the Applicable Rate. The Applicable Rate for all revolving loans is based on a pricing grid ranging from 0.500% to 1.25% per annum for Base Rate loans and 1.50% to 2.250% for Adjusted LIBO Rate loans based on the Company's Leverage Ratio (as defined in the Credit Agreement).

On May 10, 2013, the Company amended the Credit Agreement by and among the Company and the Banks to (i) permit the issuance of the Notes and the related Note Hedge and Warrant, (ii) amend certain of the restrictive covenants set forth in the Credit Agreement, (iii) increase the Leverage Ratio (as defined the Credit Agreement) to be maintained by the Company to be at or below 3.50 to 1.00, and (iv) add a covenant requiring that the Company not permit its Senior Secured Leverage Ratio (as defined in the Credit Agreement) to exceed 1.60 to 1.00. Unchanged from the initial credit agreement, the Credit Agreement contains customary representations and warranties, affirmative and negative covenants, and events of default. Also, the Company may not permit the ratio of its Consolidated EBITDA for any period of four consecutive fiscal quarters to its interest and rental expense and the amount of scheduled principal payments on long-term debt, for the same period, to be less than 2.50 to 1.00. As of December 31, 2015, the Company is in compliance with all of its covenants.

Amounts repaid under the Facility may be reborrowed. The revolving loan facility matures on the fifth anniversary of its closing and is payable in full upon maturity. The Company intends to use the new Facility from time to time for general corporate purposes, working capital and potential acquisitions.

The Company incurred $0.5 million of Credit Facility origination costs during the year ended December 31, 2013, related to the amendment and extension of the agreement. These costs have been capitalized within prepaid expenses for the current portion and other assets for the non-current portion. These fees are being amortized over the remaining term of the Credit Facility as a component of interest expense.

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Legal Matters

The Company is subject to the various legal proceedings and claims discussed below as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. Although adverse decisions (or settlements) may occur in one or more of these cases, it is not possible to estimate the possible loss or losses from each of these cases. The final resolution of these lawsuits, individually or in the aggregate, is not expected to have a material adverse effect on the Company's business, financial position or results of operations. Cases that previously were disclosed may no longer be described because of rulings in the case, settlements, changes in our business or other developments rendering them, in our judgment, no longer material to our business, financial position or results of operations.

The State of Delaware v. Shutterfly, Inc.

On May 1, 2014, the State of Delaware filed a complaint against Shutterfly for alleged violations of the Delaware False Claims and Reporting Act, 6 Del C. § 1203(b)(2). The complaint asserts that Shutterfly failed to report and remit to Delaware cash equal to the balances on unused gift cards under the Delaware Escheats Law, 12 Del. C. § 1101 et seq. The Company believes the suit is without merit.

Norberg vs. Shutterfly, Inc. et. al

On June 17, 2015, Brian Norberg on behalf of himself and all others similarly situated, brought a complaint against us in the U.S. District Court for the Northern District of Illinois. The complaint assets that the Company violated the Illinois Biometric Information Privacy Act (“IBIPA”) by extracting his and others biometric identifiers from photographs and seeks statutory damages and an injunction. On December 29, 2015, the court rejected the Company's motion to dismiss and allowed the case to proceed, however the Company continues to strenuously deny this claim.

In all cases, at each reporting period, the Company evaluates whether or not a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses accounting for contingencies. In such cases, the Company accrues for the amount, or if a range, the Company accrues the low end of the range as a component of legal expense. The Company monitors developments in these legal matters that could affect the estimate the Company had previously accrued. There are no amounts accrued which the Company believes would be material to its financial position and results of operations.

Note 8 — Stock-Based Compensation

1999 Stock Plan

In September 1999, the Company adopted the 1999 Stock Plan (the “1999 Plan”). Under the 1999 Plan, the Company issued shares of common stock and options to purchase common stock to employees, directors and consultants. Options granted under the Plan were incentive stock options or non-qualified stock options. Incentive stock options (“ISO”) were granted only to Company employees, which includes officers and directors of the Company. Non-qualified stock options (“NSO”) and stock purchase rights were able to be granted to employees and consultants. Options under the Plan were to be granted at prices not less than 85% of the deemed fair value of the shares on the date of the grant as determined by the Company’s Board of Directors (“the Board”), provided, however, that (i) the exercise price of an ISO and NSO was not less than 100% and 85% of the deemed fair value of the shares on the date of grant, respectively, and (ii) the exercise price of an ISO and NSO granted to a 10% stockholder was not less than 110% of the deemed fair value of the shares on the date of grant. The Board determined the period over which options became exercisable. The term of the options was to be no longer than five years for ISOs for which the grantee owns greater than 10% of the voting power of all classes of stock and no longer than ten years for all other options. Options granted under the 1999 Plan generally vested over four years. The Board of Directors determined that no further grants of awards under the 1999 Plan would be made after the Company's IPO.

2006 Equity Incentive Plan

In June 2006, the Board adopted, and in September 2006 the Company's stockholders approved, the 2006 Equity Incentive Plan (the "2006 Plan"), and all shares of common stock available for grant under the 1999 Plan transferred to the 2006 Plan. The 2006 Plan provides for the grant of ISOs to employees (including officers and directors who are also employees) of the Company or of a parent or subsidiary of the Company, and for the grant of all other types of awards to employees, officers, directors, consultants, independent contractors and advisors of the Company or any parent or subsidiary of the Company, provided such consultants, independent contractors and advisors render bona-fide services not in connection with the offer and sale of securities in a capitalraising transaction. Other types of awards under the 2006 Plan include NSOs, restricted stock awards, stock bonus awards, restricted stock units, and performance shares.

Options issued under the 2006 Plan are generally for periods not to exceed 10 years and are issued at the fair value of the shares of common stock on the date of grant as determined by the Board. The fair value of the Company's common stock is determined by the last sale price of such stock on the NASDAQ Global Select Market. Options issued under the 2006 Plan typically vest with respect to 25% of the shares one year after the options' vesting commencement date, and the remainder ratably on a monthly basis over the following three years.

The 2006 Plan provides for automatic increases in the maximum number of shares available for issuance on January 1, 2011, 2012, and 2013 by 3.5%, 3.3%, and 3.1%, respectively, of the number of shares of the Company's common stock issued and outstanding on the December 31 immediately prior to the date of increase and for automatic increases on January 1, 2014 and January 1, 2015 by 1,200,000 shares of the Company's common stock.

In December 2015, the 2006 Plan was superseded by the 2015 Equity Incentive Plan (the "2015 Plan").

Tiny Prints 2008 Equity Incentive Plan

In April 2011, in connection with the acquisition of Tiny Prints, the Company converted and assumed the equity awards granted under the Tiny Prints 2008 Equity Incentive Plan (the "Tiny Prints Plan"). Awards granted under the Tiny Prints Plan include ISO, NSO, and restricted share awards, all of which generally vest with respect to 25% of the shares one year after the options' vesting commencement date, and the remainder ratably on a monthly basis over the following three years. Options under this plan will expire if not exercised within 10 years from the date of grant, and options and awards will expire if forfeited due to termination.

2015 Equity Inducement Plan

In October 2015, the Board adopted the 2015 Equity Inducement Plan (the "2015 Inducement Plan"). Under the Inducement Plan, the Company issued awards to newly hired officers and to certain new employees from acquired companies. The 2015 Inducement Plan awards included time-based and performance based awards issued to two newly hired officers and vest over four years. The 2015 Inducement Plan provides for 300,000 shares of the Company's common stock available for issuance.

2015 Equity Incentive Plan

In December 2015 the Company's stockholders approved, the 2015 Plan, and all shares of common stock available for grant under the 2006 Plan transferred to the 2015 Plan. The types of awards under the 2015 Plan include restricted stock awards, stock bonus awards, restricted stock units, and performance shares. The 2015 Plan provides for 1,400,000 shares of the Company's common stock available for issuance in addition to the shares available under the 2006 plan.

Stock Option Activity

A summary of the Company's stock option activity at December 31, 2015 and changes during the period are presented in the table below (share numbers and aggregate intrinsic values in thousands):

	Number of Options	Weighted Average	Weighted Average	Aggregate Intrinsic

	Outstanding	Exercise Price	Contractual Term (Years)	Value
Balances, December 31, 2014	402	$25.42		
Granted	—	—		
Exercised	(163)	19.81		
Forfeited, canceled or expired	(33)	42.81		
Balances, December 31, 2015	206	$27.08	3.8	$3,902
Options vested and expected to vest at December 31, 2015	206	$27.07	3.8	$3,898
Options vested at December 31, 2015	198	$26.98	3.7	$3,776

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As of December 31, 2014 and 2013, there were 356,000 and 462,000 options vested, respectively.

During the years ended December 31, 2015 and 2014, the Company did not grant any stock options. In the fiscal year ended December 31, 2013, the Company granted stock options to purchase an aggregate of 2,000 shares of common stock, with a weighted average grant-date fair value of $12.55 per share.

The total intrinsic value of options exercised during the years ended December 31, 2015, 2014 and 2013 was $4.1 million, $6.1 million, and $41.5 million, respectively. Net cash proceeds from the exercise of stock options were $3.2 million for the year ended December 31, 2015.

Valuation of Stock Options

The Company estimated the fair value of each option award on the date of grant using the Black-Scholes option-pricing model and the assumptions noted in the following table. The Company calculated volatility using an average of its historical and implied volatilities as it had sufficient public trading history to cover the entire expected term. The expected term of options gave consideration to historical exercises, post vest cancellations and the options contractual term. The risk-free rate for the expected term of the option is based on the U.S. Treasury Constant Maturity at the time of grant. The assumptions used to value options granted during December 31, 2013 were as follows:

	Year Ended December 31, 2013	
Dividend yield	—	
Annual risk free rate of return	0.8	%
Expected volatility	47.0	%
Expected term (years)	4.2	

Restricted Stock Units

The Company grants restricted stock units ("RSUs") to its employees under the provisions of the 2006 Plan, 2015 Plan and inducement awards to certain new employees upon hire in accordance with NASDAQ Listing Rule 5635(c)(4). The cost of RSUs is determined using the fair value of the Company's common stock on the date of grant. RSUs typically vest and are settled annually, based on a three or four year total vesting term. Compensation cost is amortized on a straight-line basis over the requisite service period.

Restricted Stock Unit Activity

A summary of the Company's restricted stock unit activity for the year ended December 31, 2015, is as follows (share numbers in thousands):

	Number of Units Outstanding		Weighted Average Grant Date Fair Value
Awarded and unvested, December 31, 2014	3,704		$42.17
Granted	2,412		44.43
Vested	(1,617	)	39.90

Forfeited	(1,349)	43.99
Awarded and unvested, December 31, 2015	3,150	$44.28
Restricted stock units expected to vest, December 31, 2015	2,714	

The chart below summarizes grant activity during the year ended December 31, 2015 by equity plan (share numbers in thousands):

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	Grants in 2015
2006 Equity Incentive Plan	
Restricted stock units (1)	1,355
Performance-based restricted stock units (2) (3)	637
Total grants under 2006 Plan	1,992
2015 Equity Incentive Plan	
Restricted stock units (1)	155
Total grants under 2015 Plan	155
2015 Inducement Plan	
Restricted stock units (4)	70
Performance-based restricted stock units (4)	108
Total grants pursuant to Inducement Awards	178
Inducement Plan	
Restricted stock units (4)	44
Performance-based restricted stock units (4)	43
Total grants pursuant to Inducement Awards	87
Total awards granted in 2015	2,412

(1) Awards issued under the 2006 and 2015 Plan include restricted stock unit awards granted to new and current employees. Awards issued under this plan typically vest over a three or four year total vesting term.

(2) Includes performance-based restricted stock units (PBRSUs) issued under the 2006 Equity Incentive Plan to specific employees which are tied to the Company's 2015 financial performance and which have four year service criteria. Compensation cost associated with these PBRSUs is recognized on an accelerated attribution model and ultimately based on whether or not satisfaction of the performance criteria is probable. As of December 31, 2015, the performance criteria for the fiscal year was met and the associated stock-based compensation has been recognized.

(3) Also includes the PBRSUs issued to the Chief Executive Officer which are tied to multi-year performance metrics and the Company's stock performance relative to market measures. These PBRSUs also have a three year service criteria. The Company valued the market criteria using a Monte Carlo valuation model and took into consideration the likelihood of the market criteria being achieved. Compensation cost associated with these PBRSUs is recognized on an accelerated attribution model and ultimately based on whether or not satisfaction of the performance and market criteria is probable. As of December 31, 2015, the performance criteria and market criteria appeared to be attainable and the Company recognized the associated stock-based compensation. During the fourth quarter of 2015, the Chief Executive Officer announced his separation from the Company effective February 19, 2016. As a result, the Company determined that certain tranches will no longer vest and were included in award forfeitures in 2015.

(4) Inducement awards are issued to newly hired officers and to certain new employees from acquired companies. During 2015, inducement awards included time-based and performance based awards issued to two newly hired officers and vest over four years.

During the years ended December 31, 2015 and 2014, the fair value of awards vested were $64.5 million and $56.8 million, respectively.

At December 31, 2015, the Company had $97.3 million of total unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options and RSUs that will be recognized over a weighted-average period of approximately three years.

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Note 9 — Income Taxes

Income/(loss) before income taxes is as follows (in thousands):

	Year Ended December 31,		
	2015	2014	2013
United States	$(2,303)	$(10,317)	$12,570
Foreign	314	338	350
Total	$(1,989)	$(9,979)	$12,920

The components of the (benefit from)/provision for income taxes are as follows (in thousands):

	December 31,		
	2015	2014	2013
Federal:			
Current	$(23)	$(487)	$1,181
Deferred	(2,053)	(1,381)	1,870
	(2,076)	(1,868)	3,051
State:			
Current	768	704	1,711
Deferred	91	(1,038)	(1,234)
	859	(334)	477
Foreign:			
Current	258	268	412
Deferred	(187)	(185)	(305)
	71	83	107
Total income tax expense (benefit):			
Current	1,003	485	3,304
Deferred	(2,149)	(2,604)	331
	$(1,146)	$(2,119)	$3,635

The Company’s actual tax expense differed from the statutory federal income tax rate, as follows:

	December 31,		
	2015	2014	2013
Income tax expense at statutory rate	35.0 %	35.0 %	35.0 %
State income taxes	142.6	20.1	(4.5)
Stock-based compensation	8.9	2.2	(15.2)
R&D tax credit	173.5	14.8	(17.1)
Non-deductible executive compensation	(116.5)	(29.7)	20.6
Valuation allowance	(170.7)	(17.2)	8.0
Other	(15.3)	(4.0)	1.3
	57.5 %	21.2 %	28.1 %

At December 31, 2015, the Company had approximately $46.2 million, $43.6 million, and $16.8 million of federal, California and other state jurisdictions net operating loss carryforwards, respectively, to reduce future taxable income. $37.6 million, $35.5 million, and $2.8 million of the Federal, California, and other state jurisdiction net operating loss carryforwards are associated with windfall tax benefits and will be recorded as additional paid-in capital when realized. These carryforwards will expire beginning in the year 2023 and 2016 for federal and California purposes, respectively, and no sooner than 2020 for the portion related to other state jurisdictions, if not utilized.

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The Company also had research and development credit carryforwards of approximately $12.3 million and $12.9 million for federal and state income tax purposes, respectively, at December 31, 2015, of which $7.4 million and $2.5 million is associated with windfall tax benefits for federal and state income tax purposes, respectively, that will be recorded as additional paid-in capital when realized. The research and development credits may be carried forward over a period of 20 years for federal tax purposes, indefinitely for California tax purposes, and 15 years for Arizona purposes. The research and development tax credit will expire starting in 2021 for federal and 2024 for Arizona.

Internal Revenue Code limits the use of net operating loss and tax credit carryforwards in the case of an “ownership change” of a corporation. Any ownership changes, as defined, may restrict utilization of carryforwards.

The components of the net deferred tax assets as of December 31, 2015 and 2014 are as follows (in thousands):

	December 31,	
	2015	2014
Deferred tax assets:		
Net operating loss carryforwards	$3,522	$6,672
Reserves and other tax benefits	53,157	41,549
Tax credits	13,489	7,211
Deferred tax assets	70,168	55,432
Valuation allowance	(8,161)	(4,850)
Net deferred tax assets	62,007	50,582
Deferred tax liabilities:		
Depreciation and amortization	(72,744)	(63,478)
Net deferred tax liabilities	$(10,737)	$(12,896)

Realization of deferred tax assets is dependent upon the generation of future taxable income, if any, the timing and amount of which are uncertain. The valuation allowance related to deferred income taxes was $8.2 million as of December 31, 2015 and $4.9 million as of December 31, 2014. In the current year an additional valuation allowance was established on certain Arizona credits in the amount of $0.4 million. The remaining increase in the valuation allowance was attributed to the Company's generation of certain California, South Carolina, and Arizona deferred tax assets which it believes it will not be able to utilize.

Based on the Company’s assessment, excluding the valuation allowance recorded related to certain Arizona, California and South Carolina deferred tax assets that are not likely to be realized, it is more likely than not that the Company’s U.S. net deferred tax asset will be realized through future taxable earnings, and/or the reversal of existing taxable temporary differences as of December 31, 2015. Our business is cyclical and taxable income is highly dependent on revenue that historically has occurred during the fourth quarter. If there are changes to this historic trend and our fourth quarter does not yield results in-line with expectations, we may not be profitable in a given year resulting in a potential cumulative loss. When a tax planning strategy is feasible and prudent, the Company would pursue any possible tax planning strategies to avoid the expiration of our tax attributes and none have been identified or considered as of December 31, 2015. Accordingly, with exception of the valuation allowance discussed above, no additional valuation allowance has been recorded on this net asset as of December 31, 2015. The Company will continue to assess the need for a valuation allowance in the future.

As of December 31, 2015, the Company had $5.7 million of unrecognized tax benefits. A reconciliation of the beginning and ending amounts of unrecognized income tax benefits is as follows (in thousands):

	2015	2014	2013
Balance of unrecognized tax benefits at January 1	$8,566	$7,035	$5,445

Additions for tax positions of prior years	—	41	22
Additions for tax positions related to current year	1,050	1,502	1,811
Reductions for tax positions of prior years	(3,913)	(12)	(243)
Balance of unrecognized tax benefits at December 31	$5,703	$8,566	$7,035

During the current year, $3.8 million of prior year unrecognized tax benefits were recognized as a result of our 2010 audit, providing a current income tax benefit of $1.6 million.

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If the $5.7 million of unrecognized tax benefits as of December 31, 2015 is recognized, approximately $2.1 million would decrease the effective tax rate in the period in which each of the benefits is recognized. The remaining amount would be offset by the reversal of related deferred tax assets on which a valuation allowance is placed. The Company does not expect any material changes to its unrecognized tax benefits within the next twelve months.

The Company provides for federal income taxes on the earnings of its foreign subsidiary, as such, earnings are currently recognized as US taxable income.

As of December 31, 2015, the Company is subject to taxation in the United States and Israel. The Company is subject to examination for tax years including and after 2010 for federal income taxes. Certain tax years outside the normal statute of limitation remain open to audit by tax authorities due to tax attributes generated in those early years which have been carried forward and may be audited in subsequent years when utilized.

During the second quarter of 2015, the Internal Revenue Service completed its examination of the Company's tax year 2010 federal corporate income tax returns. The Company agreed with the examination results which resulted in a minimal tax payment.

Note 10 — Employee Benefit Plan

In 2000, the Company established a 401(k) plan under the provisions of which eligible employees may contribute an amount up to 50% of their compensation on a pre-tax basis, subject to IRS limitations. The Company matches employees' contributions at the discretion of the Board.

In 2015 and 2014, there were no discretionary contributions.

Note 11 — Share Repurchase Program

On October 24, 2012, the Company's Board of Directors conditionally authorized and the Audit Committee subsequently approved a share repurchase program for up to $60.0 million of the Company's common stock. On February 6, 2014, the Company's Board of Directors approved an increase to the program, authorizing the Company to repurchase up to $100.0 million of the Company's common stock in addition to any amounts repurchased as of that date. On February 9, 2015, the Company's Board of Director's approved an increase to the program, authorizing the Company to repurchase up to $300.0 million of the Company's common stock in addition to any amounts repurchased as of that date. The share repurchase program is subject to prevailing market conditions and other considerations; does not require the Company to repurchase any dollar amount or number of shares; and may be suspended or discontinued at any time. The share repurchase authorization, which was effective immediately, permits the Company to effect repurchases for cash from time to time through open market, privately negotiated or other transactions, including pursuant to trading plans established in accordance with Rules 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended, or by a combination of such methods.

In May 2015, the Company entered into an accelerated share repurchase agreement ("ASR") with a financial institution to repurchase shares of its common stock. Under the ASR, the Company prepaid $75.0 million in the second quarter of 2015. The Company accounted for the ASR as a forward contract indexed to the Company's own common stock. The Company has determined that the forward contract, indexed to its common stock, met all of the applicable criteria for equity classification.

The final settlement occurred on August 3, 2015 and approximately 0.8 million shares were delivered to the Company. The Company received a return of cash for the remaining amount not settled in shares of $38.2 million. In total, approximately 0.8 million shares of common stock were repurchased under the ASR for $36.8 million, resulting in an average price paid per share of $46.49 under the ASR. The ASR was entered into pursuant to the Company's existing share repurchase program.

In 2015, the Company repurchased 4.9 million shares of its outstanding common stock at an average price of $43.99 per share pursuant to the share repurchase program and including the shares repurchased under the ASR settled in the third quarter of 2015.

In 2014, the Company repurchased 2.0 million shares of its outstanding common stock at an average of $45.29 per share pursuant to the share repurchase program.

In 2013, the Company repurchased 0.1 million shares of its outstanding common stock at an average of $31.87 per share pursuant to the share repurchase program. All repurchased shares of common stock have been retired.

All repurchased shares of common stock have been retired.

Note 12 - Convertible Senior Notes

0.25% Convertible Senior Notes Due May 15, 2018
In May 2013, the Company issued $300.0 million aggregate principal amount of 0.25% convertible senior notes (the "Notes") due May 15, 2018 , unless earlier purchased by the Company or converted. Interest is payable semiannually in arrears on May 15 and November 15 of each year, commencing on November 15, 2013.
The Notes are governed by an Indenture between the Company, as issuer, and Wells Fargo Bank, National Association, as trustee. The Notes are unsecured and rank senior in right of payment to the Company's future indebtedness that is expressly subordinated in right of payment to the Notes and rank equal in right of payment to the Company's existing and future liabilities that are not so subordinated and are effectively subordinated in right of payment to any of the Company's cash equal to the principal amount of the Notes, and secured indebtedness to the extent of the value of the assets securing such indebtedness and are structurally subordinated to all existing and future indebtedness and liabilities incurred by the Company's subsidiaries.
Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of common stock, at the Company's election.
The initial conversion rate is 15.5847 shares of common stock per $1,000 principal amount of Notes. The initial conversion price is $64.17 per share of common stock. Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Accrued but unpaid interest will be deemed to be paid in full upon conversion rather than cancelled, extinguished or forfeited. Holders may convert their Notes only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on September 30, 2013 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any ten consecutive trading day period (the “Notes Measurement Period”) in which the "trading price" (as the term is defined in the Indenture) per $1,000 principal amount of notes for each trading day of such Notes Measurement Period was less than 98% of the product of the last reported sale price of the Company's common stock on such trading day and the conversion rate on each such trading day;
- upon the occurrence of specified corporate events; or
- at any time on or after December 15, 2017 until the close of business on the second scheduled trading immediately preceding the maturity date.

As of December 31, 2015, the Notes were not yet convertible.
In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount (“debt discount”) is amortized to interest expense over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.
In accounting for the transaction costs related to the Note issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Issuance costs attributable to the liability

component, totaling $6.4 million , are being amortized to expense over the term of the Notes, and issuance costs attributable to the equity component, totaling $1.7 million, were netted with the equity component in stockholders' equity. Additionally, the Company recorded a deferred tax asset of $0.6 million on a portion of the equity component transaction costs which are deductible for tax purposes.

Concurrently with the Note issuance, the Company repurchased 0.6 million shares of common stock for approximately $30.0 million .

The Notes consist of the following (in thousands):

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	December 31, 2015	December 31, 2014
Liability component:		
Principal	$300,000	$300,000
Less: debt discount, net of amortization	(32,382)	(44,782)
Net carrying amount	$267,618	$255,218
Equity component (1)	$63,510	63,510

(1) Recorded in the consolidated balance sheets within additional paid-in capital, net of the $1.7 million issuance costs in equity.

The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Year Ended December 31,		
	2015	2014	2013
0.25% coupon	$750	$750	$469,000
Amortization of debt issuance costs	1,247	1,179	705,000
Amortization of debt discount	12,400	11,726	7,002,000
	$14,397	$13,655	$8,176,000

Note Hedge
To minimize the impact of potential economic dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock (the “Note Hedge”). In May 2013, the Company paid an aggregate amount of $63.5 million for the Note Hedge. The Note Hedge will expire upon maturity of the Notes. The Note Hedge is intended to offset the potential dilution upon conversion of the Notes and/or offset any cash payments the Company is required to make in excess of the principal amount upon conversion of the Notes in the event that the market value per share of the Company's common stock, as measured under the Notes, is greater than the strike price of the Note Hedge, which initially corresponds to the conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the Notes.
Warrant
Separately, in May 2013, the Company entered into warrant transactions (the “Warrant”), whereby the Company sold warrants to acquire shares of the Company's common stock at a strike price of $83.18 per share. The Company received aggregate proceeds of $43.6 million from the sale of the Warrant. If the average market value per share of the Company's common stock for the reporting period, as measured under the Warrant, exceeds the strike price of the Warrant, the Warrant will have a dilutive effect on the Company's earnings per share. The Warrant is a separate transaction, entered into by the Company and is not part of the Notes or the Note Hedge, and has been accounted for as part of additional paid-in capital. Holders of the Notes and Note Hedge will not have any rights with respect to the Warrant.

Note 13 — Segment Reporting

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of its reportable segments.

The Chief Operating Decision Maker ("CODM") function uses gross profit to evaluate the performance of the segments and allocate resources. Management considers gross profit to be the appropriate metric to evaluate and compare the ongoing performance of each reportable segment as it is the level which direct costs associated with the performance of the segment are monitored. Cost of revenue for the Consumer segment consists of costs directly attributable to the production of personalized products for all of the Company's brands, including direct materials, shipping charges, and payroll and related expenses for direct labor; rent for production facilities, and depreciation of production equipment and facilities where we are the deemed owner. Cost of revenue for the Enterprise segment consists of costs which are direct and incremental to the Enterprise business. These include production costs of Enterprise products, such as materials, labor and printing costs and costs associated with third-party production of goods. They also include shipping costs and indirect overhead.

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Due to the nature of the Company's operations, a majority of its assets are utilized across all segments. In addition, segment assets are not reported to, or used by, the CODM to allocate resources or assess performance of the Company's segments. Accordingly, the Company has not disclosed asset information by segment.
The Company’s segments are determined based on the products and services it provides and how the CODM evaluates the business. The Company has the following reportable segments:
Consumer - Includes sales from the Company's brands and are derived from the sale of photo-based products, such as photo books, stationery and greeting cards, other photo-based merchandise, photo prints, and the related shipping revenues as well as rental revenue from its BorrowLenses brand.
Enterprise - Includes revenues primarily from variable, four-color direct marketing collateral manufactured and fulfilled for business customers.

In addition to the above reportable segments, the Company has a corporate category that includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation and amortization of intangible assets.
The Company's segment results for fiscal 2015, 2014 and 2013 were as follows (dollars in thousands):

	Year Ended December 31,		
	2015	2014	2013
Consumer			
Net revenues	$961,418	$870,959	$745,970
Cost of net revenues	436,050	394,265	327,145
Gross profit	$525,368	$476,694	$418,825
Gross profit as a percentage of net revenues	55 %	55 %	56 %
Enterprise			
Net revenues	$98,011	$50,621	$37,672
Cost of net revenues	79,789	43,456	29,480
Gross profit	$18,222	$7,165	$8,192
Gross profit as a percentage of net revenues	19 %	14 %	22 %
Corporate			
Net revenues	$—	$—	$—
Cost of net revenues	12,239	14,999	12,968
Gross profit	$(12,239)	$(14,999)	$(12,968)
Consolidated			
Net revenues	$1,059,429	$921,580	$783,642
Cost of net revenues	528,078	452,720	369,593
Gross profit	$531,351	$468,860	$414,049
Gross profit as a percentage of net revenues	50 %	51 %	53 %

Note 14 - Related Party Transactions

The Company’s Chief Executive Officer, Jeffrey Housenbold, was appointed to Chegg, Inc.'s ("Chegg") Board of Directors in May 2013 and to Groupon, Inc.'s ("Groupon") Board of Directors in October 2013. During the year ended December 31, 2015, the Company conducted business with both Groupon and Chegg. The Company's business with Groupon during the year consisted primarily of offering its products as part of Groupon’s flash deals. The Company's business with Chegg primarily consisted of advertising campaigns, and commercial print services with its Enterprise segment.

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During the years ended December 31, 2015, 2014 and 2013, the Company paid approximately $3.5 million, $3.3 million, and $2.7 million, respectively, in commissions to Groupon related to these Flash deals. As of December 31, 2015 and 2014, the Company had a receivable balance of approximately $0.8 million and $0.5 million, respectively, with Groupon.

During the years ended December 31, 2015 and 2014, the Company earned revenue of approximately $0.5 million from Chegg. The Company did not earn any revenue from Chegg in 2013. As of December 31, 2015, the Company did not have a receivable balance with Chegg. The Company had a receivable balance of approximately $0.5 million as of December 31, 2014.

The Company's Board of Directors includes Michael Zeisser who was appointed to XO Group Inc.'s ("XO Group") Board of Directors in July 2013. During the year ended December 31, 2015, the Company conducted business with XO Group which consisted of various marketing campaigns. The Company paid XO Group approximately $1.8 million, $1.4 million, and $0.8 million during the years ended December 31, 2015, 2014 and 2013, respectively. The Company had a payable balance of approximately $0.2 million as of December 31, 2015 and 2014 with XO Group.

Management believes that these transactions are at arms length and on similar terms as would have been obtained from unaffiliated third parties.

Note 15 — Restructuring

During the first quarter of 2015, the Company decided to discontinue the Treat brand as well as close the manufacturing operations in Elmsford, New York as part of the Company's strategic initiatives. The assets related to the Treat brand were written off in the first quarter of 2015 upon discontinuation of the Treat brand. In the third quarter of 2015, the Company stopped production at the Elmsford, New York manufacturing facility and ceased-use of the manufacturing space. As a result of exiting the facility prior to the lease termination date, the Company recorded a liability of $2.1 million the net present value of future rent payments, adjusted for potential sublease income. The Company will continue to incur employee severance and benefit expenses due to a reduction to headcount as a result of the restructuring activities. These restructuring costs will impact cost of net revenues and operating expenses through the first quarter of 2016.

The following table summarizes the restructuring costs recognized during the year ended December 31, 2015:

	Year Ended December 31, 2015 (in thousands)
Employee severance and benefits	$1,043
Other associated costs	2,494
Total	$3,537

The following table summarizes the restructuring activity during the year ended December 31, 2015:

	Employee Severance and Benefits	Other Associated Costs	Total
Accrued liability as of January 1, 2015	$—	$—	$—
Charges	1,043	2,494	3,537
Payments	(577)	—	(577)
Other adjustments	—	(435)	(435)

Accrued liability as of December 31, 2015	$466	$2,059	$2,525

Note 16 — Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for the years ended December 31, 2015 and 2014 are as follows (in thousands, except per share amounts):

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	Year Ended December 31, 2015			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenues	$159,978	$183,879	$167,492	$548,080
Gross profit	$65,271	$87,232	$59,501	$319,347
Net income/(loss)	$(45,103)	$(23,777)	$(63,077)	$131,114
Net income/(loss) per common share:				
Basic	$(1.19)	$(0.63)	$(1.73)	$3.73
Diluted	$(1.19)	$(0.63)	$(1.73)	$3.57

	Year Ended December 31, 2014			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenues	$137,099	$159,148	$142,008	$483,325
Gross profit	$60,756	$75,813	$52,282	$280,009
Net income/(loss)	$(34,214)	$(27,052)	$(46,244)	$99,650
Net income/(loss) per common share:				
Basic	$(0.89)	$(0.70)	$(1.20)	$2.59
Diluted	$(0.89)	$(0.70)	$(1.20)	$2.51

Schedule II
Valuation and Qualifying Accounts

	Balance at Beginning of Period In thousands	Additions Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
Allowance for Doubtful Accounts Receivable					
Year ended December 31, 2013	$231	(140)	—	(79)	$12
Year ended December 31, 2014	$12	7	—	(18)	$1
Year ended December 31, 2015	$1	37	—	(28)	$10
Tax Valuation Allowance					
Year ended December 31, 2013	$2,203	1,049	—	(380)	$2,872
Year ended December 31, 2014	$2,872	1,978	—	—	$4,850
Year ended December 31, 2015	$4,850	3,394	—	(83)	$8,161

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure 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 December 31, 2015. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, (“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. 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.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company’s disclosure controls and procedures as of the end of the period covered by this annual report on Form 10-K. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2015, our disclosure controls and procedures were effective at the reasonable assurance level.

Management’s Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15(d)-15(f) under the Exchange Act. The Company’s internal control over financial reporting is a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may change over time.

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2015.

The Company reviewed the results of management’s assessment with the Audit Committee of the Board of Directors. The effectiveness of the Company's internal control over financial reporting as of December 31, 2015 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

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Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2015 that materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

Limitation on Effectiveness of Controls

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information concerning our directors required by this Item is incorporated by reference to the section in our Proxy Statement entitled “Proposal No. 1 — Election of Directors.”

The information concerning our executive officers required by this Item is incorporated by reference to the section in our Proxy Statement entitled “Executive Officers.”

The information concerning compliance with Section 16(a) of the Securities Exchange Act of 1934 required by this Item is incorporated by reference to the section in our Proxy Statement entitled “Section 16(a) Beneficial Ownership Reporting Compliance.”

We have adopted a written code of ethics for financial employees that applies to our principal executive officer, principal financial officer, principal accounting officer, controller and other employees of the finance department designated by the Company’s Chief Financial Officer. This code of ethics, titled the “Code of Conduct and Ethics for Chief Executive Officer and Senior Financial Department Personnel,” can be found on our website at www.shutterfly.com. We intend to make all required disclosures concerning any amendments to, or waivers from, our code of ethics on our website.

The information concerning material changes to the procedures by which stockholders may recommend nominees to the Board of Directors required by this Item, if any, is incorporated by reference to information set forth in the Proxy Statement, in the section entitled “Information Regarding the Board of Directors and its Committees.”

The information concerning the audit committee of the Board of Directors and the audit committee financial experts required by this Item is incorporated by reference to information set forth in the Proxy Statement, in the section entitled “Information Regarding the Board of Directors and its Committees.”

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this Item with respect to executive compensation, risk management and the compensation committee of the Board of Directors is incorporated by reference to information set forth in the Proxy Statement in the sections entitled "Executive Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required by this Item is incorporated by reference to information set forth in the Proxy Statement in the sections entitled “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information.”

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information concerning certain relationships and related transactions required by this Item is incorporated by reference to information set forth in the Proxy Statement in the section entitled “Certain Transactions.”

The information required by this Item with respect to director independence is incorporated by reference to information set forth in the Proxy Statement in the section entitled "Independence of Board of Directors and its Committees."

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information concerning principal accounting fees and services required by this Item is incorporated by reference to the section in our Proxy Statement entitled “Ratification of Selection of Independent Registered Public Accounting Firm.”

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE.

(a) The following documents are filed as part of this annual report on Form 10-K:

1. Financial Statements. The consolidated financial statements of Shutterfly, Inc. are incorporated by reference to Part II, Item 8 of this annual report on Form 10-K.

2. Financial Statement Schedule. The Valuation and Qualifying Accounts schedule is incorporated by reference to Part II, Item 8 of this annual report.

3. Exhibits. We have filed, or incorporated into this report by reference, the exhibits listed on the accompanying Index to Exhibits immediately following the signature page of this Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

SHUTTERFLY, INC.
(Registrant)

Dated: February 12, 2016	By:	/s/ Michael Pope
		Michael Pope
		Senior Vice President and Chief Financial Officer
		(Principal Financial Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Jeffrey T. Housenbold, Brian M. Regan and Brian R. Manca, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Annual Report on Form 10-K and to file same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and dates indicated.

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Signature	Title	Date
/s/ Jeffrey T. Housenbold Jeffrey T. Housenbold	President, Chief Executive Officer and Director (Principal Executive Officer)	February 12, 2016
/s/ Michael Pope Michael Pope	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 12, 2016
/s/ Lisa Blackwood-Kapral Lisa Blackwood-Kapral	Vice President and Chief Accounting Officer (Principal Accounting Officer)	February 12, 2016
/s/ Philip A. Marineau Philip A. Marineau	Chairman of the Board of Directors and Director	February 12, 2016
/s/ Eric J. Keller Eric J. Keller	Director	February 12, 2016
/s/ Ann Mather Ann Mather	Director	February 12, 2016
/s/ Nancy J. Schoendorf Nancy J. Schoendorf	Director	February 12, 2016
/s/ Brian T. Swette Brain T. Swette	Director	February 12, 2016
/s/ Michael P. Zeisser Michael P. Zeisser	Director	February 12, 2016
/s/ Mario Cibelli Mario Cibelli	Director	February 12, 2016
/s/ Thomas D. Hughes Thomas D. Hughes	Director	February 12, 2016

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INDEX TO EXHIBITS

		Incorporated by Reference				
Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Provided Herewith
3.01	Restated Certificate of Incorporation.	S-1	333-135426	June 29, 2006	3.03	
3.02	Restated Bylaws.	10-Q	001-33031	July 31, 2012	3.02	
4.01	Form of common stock certificate.	S-1/A	333-135426	August 18, 2006	4.01	
4.02	Indenture, dated as of May 20, 2013, by and between Shutterfly, Inc. and Wells Fargo Bank, National Association, as trustee.	8-K	001-33031	May 20, 2013	4.01	
10.01	Form of Indemnity Agreement.*	S-1	333-135426	June 29, 2006	10.01	
10.02	1999 Stock Plan and forms of stock option agreement and a stock option exercise agreement.*	S-1	333-135426	June 29, 2006	10.02	
10.03	2006 Equity Incentive Plan, as amended.*	10-Q	001-33031	November 5, 2013	10.01	
10.04	Forms of stock option agreement, stock option exercise agreement, restricted stock agreement, restricted stock unit agreement, stock appreciation right agreement and stock bonus agreement under the 2006 Equity Incentive Plan, as amended.*	10-K	001-33031	February 7, 2011	10.24	
10.05	Form of Inducement Restricted Stock Unit Award Agreement.*	10-K	001-33031	February 14, 2013	10.04	
10.06	2015 Equity Incentive Plan.*	DEF 14A	001-33031	November 18, 2015	Appendix A	
10.07	Forms of restricted stock unit agreements, stock appreciation right agreement and stock bonus agreement under the 2015 Equity Incentive Plan.*	S-8	001-33031	December 30, 2015	99.1	
10.08	Shutterfly, Inc. 2015 CEO Compensation Plan. (as amended May 22, 2015).*	10-Q	001-33031	August 6, 2015	10.01	
10.09	Shutterfly, Inc. 2015 Quarterly Bonus Plan (CEO & eStaff).*	10-Q	001-33031	May 7, 2015	10.02	
10.1	Shutterfly, Inc. Executive Stock Ownership Guidelines, as amended.*	10-Q	001-33031	May 3, 2012	10.03	
10.11	Offer letter dated January 5, 2005 for Jeffrey T. Housenbold.*	S-1	333-135426	June 29, 2006	10.08	
10.12	Amendment to Employment Agreement dated December 8, 2008 for Jeffrey T. Housenbold.*	10-Q	001-33031	May 1, 2009	10.02	
10.13	Amendment Number 2 to Employment Agreement dated March 12, 2009 for Jeffrey T. Housenbold.*	10-Q	001-33031	May 1, 2009	10.03	
10.14		8-K	001-33031	December 1, 2015		

	Amendment Number 4 to Employment Agreement dated November 30, 2015 for Jeffrey T. Housenbold.*				
10.15	Offer Letter dated March 21, 2005 for Dan McCormick.*	10-Q	001-33031	May 3, 2010	10.03

10.16	Amendment to Offer Letter dated December 26, 2008 for Dan McCormick.*	10-Q	001-33031	May 3, 2010	10.04
10.17	Amendment Number 3 to Offer Letter dated December 10, 2015 for Dan McCormick.*	8-K	001-33031	December 10, 2015	99.2
10.18	Offer letter dated January 17, 2007 for Dwayne Black.*	10-K	001-33031	March 20, 2007	10.15
10.19	Amendment to Offer Letter dated December 23, 2008 for Dwayne Black.*	10-K	001-33031	February 24, 2009	10.2
10.20	Offer Letter dated March 5, 2012 for John Boris.*	10-Q	001-33031	May 7, 2013	10.02
10.21	Offer Letter dated October 9, 2014 for Satish Menon.*	10-K	001-33031	February 18, 2015	10.18
10.22	Supply Agreement, dated as of April 20, 2007, by and between Shutterfly, Inc. and FUJIFILM U.S.A, Inc.**	10-Q	001-33031	August 1, 2007	10.18
10.23	Amendment No. 2 to Fulfillment Agreement and Amendment No. 1 to Supply Agreement, dated as of March 29, 2010, by and between Shutterfly, Inc. and FUJIFILM North America Corporation.**	10-Q	001-33031	May 3, 2010	10.01
10.24	Amendment No. 2 to Supply Agreement made as of August 23, 2012 by and between Shutterfly, Inc. and FUJIFILM North America Corporation.**	10-Q	001.33031	November 6, 2012	10.02
10.25	Credit Agreement, dated as of November 22, 2011, by and among the Shutterfly, Inc., the Lenders (as defined therein) and JPMorgan Chase Bank, N.A.	10-K	001-33031	February 13, 2012	10.25
10.26	Amendment No. 1 to Credit Agreement, dated as of May 10, 2013, by and among Shutterfly, Inc., the Lenders (as defined therein) and JPMorgan Chase Bank, N.A., as administrative agent.	8-K	001-33031	May 13, 2013	10.01
10.27	Incremental Commitment Agreement dated as of December 6, 2013. by and among Shutterfly, Inc., the Incremental Lenders (as defined therein) and JPMorgan Chase Bank, N.A.	10-K	001-33031	February 12, 2014	10.07
10.28	Letter Agreement, dated May 14, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.01

10.29	Letter Agreement, dated May 14, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.02
10.30	Letter Agreement, dated May 14, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.03
10.31	Letter Agreement, dated May 14, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.04

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10.32	Letter Agreement, dated May 14, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.05
10.33	Letter Agreement, dated May 14, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.06
10.34	Letter Agreement, dated May 14, 2013, between Bank of America, N.A. and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.07
10.35	Letter Agreement, dated May 14, 2013 between Bank of America, N.A. and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.08
10.36	Letter Agreement, dated May 15, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.09
10.37	Letter Agreement, dated May 15, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Additional Call Option Transaction.	8-K	001-33031	May 20, 2013	10.10
10.38	Letter Agreement, dated May 15, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.11
10.39	Letter Agreement, dated May 15, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Additional Call Option Transaction.	8-K	001-33031	May 20, 2013	10.12
10.40	Letter Agreement, dated May 15, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.13
10.41	Letter Agreement, dated May 15, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Additional Call Option Transaction.	8-K	001-33031	May 20, 2013	10.14
10.42	Letter Agreement, dated May 15, 2013, between Bank of America, N.A. and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.15
10.43	Letter Agreement, dated May 15, 2013 between Bank of America, N.A. and Shutterfly, Inc. regarding the Additional	8-K	001-33031	May 20, 2013	10.16

	Call Option Transaction.					
10.44	Offer Lettered dated October 23. 2015, by and between Shutterfly, Inc. and Mike Pope.*	8-K	001-33031	October 27, 2015	10.1	
10.45	Form of Executive Retention Agreement.	8-K	001-33031	December 28, 2015	99.1	
23.01	Consent of Independent Registered Public Accounting Firm.					X
24.01	Power of Attorney. (See signature page of this Form 10-K).					X

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31.01	Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).	X
31.02	Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).	X
32.01	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).***	X
32.02	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).***	X
101	The following financial statements from Shutterfly Inc.'s Annual Report on Form 10-K for the year ended December 31, 2015, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Stockholders' Equity, (iv) Consolidated Statements of Comprehensive Income/(Loss), (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements, tagged at Level I through IV.	X

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* Represents a management contract or compensatory plan.

** Confidential treatment has been granted for certain portions of this document pursuant to an application for confidential treatment sent to the Securities and Exchange Commission. Such portions are omitted from this filing and were filed separately with the Securities and Exchange Commission.

*** This certification is not deemed “filed” for purposes of Section 18 of the Securities Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that Shutterfly specifically incorporates it by reference.