Alarm.com Holdings, Inc.
Form 10-Q
August 07, 2018

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-37461

ALARM.COM HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	26-4247032
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
8281 Greensboro Drive, Suite 100, Tysons, Virginia	22102
(Address of principal executive offices)	(zip code)

Tel: (877) 389-4033
(Registrant's telephone number, including area code)

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

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

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

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

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

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

As of July 31, 2018, there were 47,695,625 outstanding shares of the registrant's common stock, par value $0.01 per share.

ALARM.COM HOLDINGS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE FISCAL QUARTER ENDED JUNE 30, 2018

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS (unaudited)

ALARM.COM HOLDINGS, INC.
Condensed Consolidated Statements of Operations
(in thousands, except share and per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue:				
SaaS and license revenue	$70,968	$58,928	$138,956	$109,154
Hardware and other revenue	33,520	27,060	58,288	51,028
Total revenue	104,488	85,988	197,244	160,182
Cost of revenue[(1)]:				
Cost of SaaS and license revenue	11,027	8,500	21,833	16,592
Cost of hardware and other revenue	25,461	21,335	43,032	39,878
Total cost of revenue	36,488	29,835	64,865	56,470
Operating expenses:				
Sales and marketing	14,612	11,899	25,434	22,213
General and administrative	18,119	13,450	34,281	28,825
Research and development	21,521	20,062	41,898	34,583
Amortization and depreciation	5,238	4,846	10,263	7,710
Total operating expenses	59,490	50,257	111,876	93,331
Operating income	8,510	5,896	20,503	10,381
Interest expense	(751)	(674)	(1,423)	(890)
Other income, net	420	137	816	374
Income before income taxes	8,179	5,359	19,896	9,865
Benefit from income taxes	(2,554)	(4,506)	(1,352)	(3,963)
Net income	10,733	9,865	21,248	13,828
Income allocated to participating securities	(1)	(5)	(4)	(8)
Net income attributable to common stockholders	$10,732	$9,860	$21,244	$13,820
Per share information attributable to common stockholders:				
Net income per share:				
Basic	$0.23	$0.21	$0.45	$0.30
Diluted	$0.22	$0.20	$0.43	$0.28
Weighted average common shares outstanding:				
Basic	47,439,311	46,442,327	47,333,435	46,334,499
Diluted	49,497,088	49,000,553	49,406,444	48,906,812

(1) Exclusive of amortization and depreciation shown in operating expenses below.

See accompanying notes to the condensed consolidated financial statements.

ALARM.COM HOLDINGS, INC.
Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)
(unaudited)

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$105,959	$ 96,329
Accounts receivable, net	52,553	40,634
Inventory, net	14,718	14,177
Other current assets	20,681	12,796
Total current assets	193,911	163,936
Property and equipment, net	26,587	23,459
Intangible assets, net	86,669	94,286
Goodwill	63,591	63,591
Deferred tax assets	18,826	18,444
Other assets	13,212	7,925
Total assets	$402,796	$ 371,641
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable, accrued expenses and other current liabilities	$32,130	$ 29,084
Accrued compensation	10,056	12,127
Deferred revenue	3,460	3,292
Total current liabilities	45,646	44,503
Deferred revenue	8,511	9,386
Long-term debt	69,000	71,000
Other liabilities	13,441	13,925
Total liabilities	136,598	138,814
Commitments and contingencies (Note 10)		
Stockholders' equity		
Preferred stock, $0.001 par value, 10,000,000 shares authorized; no shares issued and outstanding as of June 30, 2018 and December 31, 2017.	—	—
Common stock, $0.01 par value, 300,000,000 shares authorized; 47,698,797 and 47,215,720 shares issued; and 47,691,722 and 47,202,310 shares outstanding as of June 30, 2018 and December 31, 2017, respectively.	477	472
Additional paid-in capital	330,028	321,032
Accumulated deficit	(64,307)	(88,677)
Total stockholders' equity	266,198	232,827
Total liabilities and stockholders' equity	$402,796	$ 371,641

See accompanying notes to the condensed consolidated financial statements.

ALARM.COM HOLDINGS, INC.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Six Months Ended June 30,					
Cash flows from operating activities:	2018			2017		
Net income	$	21,248		$	13,828	
Adjustments to reconcile net income to net cash from operating activities:						
Provision for doubtful accounts	57			20		
Reserve for product returns	174			1,144		
Amortization on patents and tooling	512			574		
Amortization and depreciation	10,263			7,710		
Amortization of debt issuance costs	54			47		
Deferred income taxes	(1,338		)	(2,833		)
Undistributed losses from equity investees	—			120		
Stock-based compensation	6,213			3,228		
Disposal of property and equipment	285			—		
Changes in operating assets and liabilities (net of business acquisitions):						
Accounts receivable	(12,150		)	(1,998		)
Inventory	(541		)	579		
Other assets	(9,492		)	(5,425		)
Accounts payable, accrued expenses and other current liabilities	1,110			7,602		
Deferred revenue	(707		)	(495		)
Other liabilities	(484		)	635		
Cash flows from operating activities	15,204			24,736		
Cash flows used in investing activities:						
	—			(154,289		)

Business acquisitions, net of cash acquired					
Additions to property and equipment	(6,131	)	(5,714		)
Issuances of notes receivable	—		(4,000		)
Cash flows used in investing activities	(6,131	)	(164,003		)
Cash flows from financing activities:					
Proceeds from credit facility	—		67,000		
Repayments of credit facility	(2,000	)	(1,000		)
Repurchases of common stock	(1	)	(2		)
Issuances of common stock from equity based plans	2,558		1,551		
Cash flows from financing activities	557		67,549		
Net increase / (decrease) in cash and cash equivalents	9,630		(71,718		)
Cash and cash equivalents at beginning of the period	96,329		140,634		
Cash and cash equivalents at end of the period	$ 105,959		$	68,916	

See accompanying notes to the condensed consolidated financial statements.

4

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements
June 30, 2018 and 2017
(unaudited)

Note 1. Organization

Alarm.com Holdings, Inc. (referred to herein as Alarm.com, the Company, or we) is the leading platform for the intelligently connected property. We offer a comprehensive suite of cloud-based solutions for the smart residential and commercial property, including interactive security, video monitoring, intelligent automation and energy management. Millions of property owners rely on our technology to intelligently secure, monitor and manage their residential and commercial properties. Our solutions are delivered through an established network of over 7,000 trusted service provider partners, who are experts at selling, installing and supporting our solutions. We derive revenue from the sale of our cloud-based Software-as-a-Service, or SaaS, services, license fees, software, hardware, activation fees and other revenue. Our fiscal year ends on December 31.

Note 2. Basis of Presentation

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include our accounts and those of our majority-owned and controlled subsidiaries after elimination of intercompany accounts and transactions.

These unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial information and the applicable rules and regulations of the Securities and Exchange Commission, or SEC. Accordingly, they do not include all the information and footnotes required by GAAP for annual financial statements. They should be read together with our audited consolidated financial statements and related notes thereto for the year ended December 31, 2017 included in our Annual Report on Form 10-K filed with the SEC on February 28, 2018, or the 2017 Annual Report. The condensed consolidated balance sheet as of December 31, 2017 was derived from our audited financial statements, but does not include all disclosures required by GAAP for annual financial statements.

In the opinion of management, these condensed consolidated financial statements include all normal recurring adjustments necessary for a fair statement of the results of operations, financial position and cash flows. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results that can be expected for our entire fiscal year ending December 31, 2018.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates. Estimates are used when accounting for revenue recognition, allowances for doubtful accounts, allowance for hardware returns, estimates of obsolete inventory, long-term incentive compensation, stock-based compensation, income taxes, legal reserves, contingent consideration and goodwill and intangible assets.

Significant Accounting Policies

Except for as disclosed herein, there have been no other material changes to our significant accounting policies during the three and six months ended June 30, 2018 from those disclosed in our 2017 Annual Report.

Revenue Recognition

We derive our revenue from three primary sources: the sale of cloud-based SaaS services on our integrated Alarm.com platform, the sale of licenses and services on the Connect software platform and the sale of hardware products. We sell our platform and hardware solutions to service provider partners that resell our solutions and hardware to residential and commercial property owners, who are the service provider partners' customers. Our subscribers consist of all of the properties maintained by those residential and commercial property owners to which we are delivering at least one of our solutions. We also sell our hardware to distributors who resell the hardware to service provider partners. We enter into contracts with our service provider partners that establish pricing for access to our platform solutions and for the sale of hardware. These contracts typically have an initial term of one year, with subsequent renewal terms of one year. Our service provider partners typically enter into contracts with our subscribers, which our service provider partners have indicated range from three to five years in length.

Our hardware includes cellular radio modules that enable access to our cloud-based platforms, as well as video cameras, image sensors and other peripherals. Our service provider partners may purchase our hardware in anticipation of installing the hardware in a residential or commercial property when they create a new subscriber account, or for use in existing subscriber properties. The purchase of hardware occurs in a transaction that is separate and typically in advance of the purchase of our platform services. The performance obligation is satisfied when the hardware is received by our service provider partner or distributor. Service provider partners transact with us to purchase our platform solutions and resell our solutions to a new subscriber, or to upgrade or downgrade the solutions of an existing subscriber, at which time the subscriber's access to our platform solutions is enabled and the delivery of the services commences. Our performance obligation related to providing our platform solutions is satisfied on a daily basis as the subscriber uses the platform services. The purchase of platform solutions and the purchase of hardware are separate transactions as revenue is recognized when control of the promised goods or services are transferred to our customers, in an amount that reflects the consideration that we expect to receive in exchange for those goods or services. We generate all of our revenue from contracts with customers.

SaaS and license revenue associated with our contracts is invoiced and revenue is recognized at an amount that corresponds directly with the value of the performance completed to date. Additionally, the consideration received from hardware sales corresponds directly with the stand-alone selling price of the hardware. As a result, we have elected to use the practical expedient related to the amount of transaction price allocated to the unsatisfied performance obligations and therefore, we have not disclosed the total remaining revenue expected to be recognized on all contracts or the expected period over which the remaining revenue would be recognized for the current period or any period presented before January 1, 2018.

To determine the transaction price, we analyze all of the performance obligations included in the contract. We consider the terms of the contract and our customary business practices, which typically do not include financing components or non-cash consideration. We have variable consideration in the form of retrospective volume discounts, rebate incentives, restocking fees and assurance-type warranties. The significant inputs related to variable consideration include the volume and amount of products and services sold historically and expected to be sold in the future, the availability and performance of our services and the historical and expected number of returns. Depending on the type of variable consideration and its predictability, we may apply an "expected value" approach or a "most likely amount" approach. We estimate the variable consideration at the onset of a contract and include the variable consideration within the transaction price if it is probable that a significant reversal of the variable consideration would not occur in the future. When determining whether the amount of variable consideration included in the transaction price should be constrained, we look at the history of hardware purchased and subscribers added by our service provider partners to estimate the likelihood of those service provider partners obtaining the retrospective volume discounts and rebates. At times, our contracts include consideration payable to a customer in the form of fixed discounts or rebates. We record the consideration payable to a customer as a reduction to the transaction price resulting in a reduction to revenue over the service period.

If we enter into contracts that contain multiple promised services, we evaluate which of the promised services represent separate performance obligations based on whether or not the promised services are distinct and whether or not the services are separable from other promises in the contract. If these criteria are met, then we allocate the transaction price to the performance obligations using the relative stand-alone selling price method at contract inception.

In determining the relative estimated selling prices, we consider market conditions, entity-specific factors and information about the customer or class of customer. Any discount within the contract is allocated proportionately to all of the separate performance obligations in the contract unless the terms of discount relate specifically to the entity's efforts to satisfy some but not all of the performance obligations.

For our standard service provider agreements, we have used a portfolio approach for purposes of revenue recognition, as each agreement has similar characteristics and we do not expect the effects of applying this approach would have a material impact on our financial statements as compared to assessing each agreement individually.

SaaS and License Revenue

We generate the majority of our SaaS and license revenue primarily from monthly fees charged to our service provider partners sold on a per subscriber basis for access to our cloud-based intelligently connected property platform and related solutions. Our fees per subscriber vary based upon the service plan and features utilized.

Under the terms of our contractual arrangements with our service provider partners, we bill a monthly fee to our service provider partners in advance of the month of service, with the exception of the initial partial month of service, which is paid in arrears. Due to the limited period of time between receipt of payment and delivery of service, we have not accounted for these advance payments as significant financing components. We typically transfer the promised SaaS services to our customers over time, which is evidenced by the fact that the customers receive and consume the benefits provided by our performance of the services as such services are rendered. As a result, we recognize revenue from SaaS services on a monthly basis as we satisfy our performance obligations. We have demonstrated that we can sell our SaaS offering on a stand-alone basis, as it can be sold separately from hardware and activation services. As there is neither a minimum required initial service term nor a stated renewal term in our contractual arrangements, we recognize revenue over the period of service, which is monthly. Our service provider partners typically incur and pay the same monthly fee per subscriber account for the entire period a subscriber account is active.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

We offer multiple service level packages for our platform solutions including a range of solutions and a range of a la carte add-ons for additional features. The fee paid by our service provider partners each month for the delivery of our solutions is based on the combination of packages and add-ons enabled for each subscriber. We utilize tiered pricing plans where our service provider partners may receive prospective pricing discounts driven by volume.

We also generate SaaS and license revenue from the fees paid to us when we license our intellectual property to third parties for use of our patents. We bill a monthly fee to third parties based on the number of customers that were active during the prior month. We apply the usage-based royalty exception to recognize license revenue because the sole or predominant item to which the royalty relates is the license of intellectual property. Under the usage-based royalty exception, we recognize revenue on a monthly basis over the period of service. In addition, in certain markets our EnergyHub subsidiary sells its demand response service for an annual service fee, with pricing based on the number of subscribers or amount of aggregate electricity demand made available for a utility’s or market’s control.

Software License Revenue

Our SaaS and license revenue also includes our software license revenue from monthly fees charged to service providers sold on a per subscriber basis for access to our Connect software platform. The Connect software for interactive security, automation and related solutions is typically deployed and operated by the service provider in its own network operations center. Our agreements for the Connect platform solution typically include software and services, such as post-contract customer support, or PCS. Software sales that include multiple elements are typically allocated to the various elements using the relative stand-alone selling price method. We apply the usage-based royalty exception to recognize license revenue associated with software hosted by our customers because the predominant item to which the royalty relates is the license of intellectual property. Under the usage-based royalty exception, we recognize revenue on a monthly basis over the period during which the services are expected to be performed. Under the terms of our contractual arrangements with our service provider partners, we are entitled to payment of a monthly fee that is billed per subscriber for the month of service. Our software license revenue during the three and six months ended June 30, 2018 was $10.2 million and $20.1 million, respectively, as compared to $8.5 million and $10.8 million for the same periods in the prior year.

Hardware and Other Revenue

We generate hardware and other revenue primarily from the sale of video cameras and cellular radio modules that provide access to our cloud-based platforms and, to a lesser extent, the sale of other devices, including image sensors and peripherals. We primarily transfer hardware to our customers upon delivery to the customer, which corresponds with the time at which the customer obtains legal title to the hardware. As a result, we recognize hardware and other revenue as we satisfy our performance obligations, which occurs when the hardware is received by our service provider partner or distributor, net of a reserve for estimated returns. There are a few contracts in which we provide shipping and handling services to the customer after control of the hardware transfers to the customer. In these instances, we have elected to account for shipping and handling costs as activities performed to fulfill the promise to transfer hardware to the customer and not as a separate promised service.

Amounts due from the sale of hardware are payable in accordance with the terms of our agreements with our service provider partners or distributors, and are not contingent on resale to end-users, or to service provider partners in the case of sales of hardware to distributors. Payment for our hardware is typically due within 30 days from shipment, with the exception of certain hardware finance arrangements, which are paid over a 36-month period. Our terms for hardware sales sold directly to either service provider partners or distributors typically allow for the return of hardware up to one year past the date of sale. Our distributors sell directly to our service provider partners under terms between the two parties.

When determining the amount of consideration we expect to be entitled to for the sale of our hardware, we estimate the variable consideration associated with customer returns. We record a reserve against revenue for hardware returns based on historical returns, which was 2% of hardware and other revenue for each of the twelve months ended June 30, 2018 and 2017. We evaluate our hardware reserve on a quarterly basis or if there is an indication of significant changes in return experience. Historically, our returns of hardware have not significantly differed from our estimated reserve. In general, we provide assurance-type warranties related to the intended functionality of the products and services provided. These warranties were not identified as separate performance obligations.

Hardware and other revenue also includes activation fees charged to service provider partners for activation of a new subscriber account on our platforms, as well as fees paid by service provider partners for our marketing services. Our service provider partners use services on our platforms, such as support tools and applications, to assist in the installation of our solutions in subscriber properties. This installation marks the beginning of the service period on our platforms and, on occasion, we earn activation revenue for fees charged for this service. The activation fee is non-refundable, separately negotiated and specified in our contractual arrangements with our service provider partners and is charged to the service provider partner for each subscriber activated on our platforms. The decision whether to charge an activation fee is based in part on the expected number of subscribers to be added by our service provider partners and as a result, many of our largest service provider partners do not pay an activation fee. Activation fees are not offered on a stand-alone basis separate from our SaaS offering and are billed and received at the beginning of the arrangement. We record activation fees initially as deferred revenue and we recognize these fees ratably over the expected term of the subscribers' account which we estimate is ten years based on our annual attrition rate. The portion of these activation fees included in current and long-term deferred revenue as of our balance sheet date represents the amounts that will be recognized ratably as revenue over the following twelve months, or longer as appropriate, until the ten-year expected term is complete. The balance of deferred revenue for activation fees was $9.9 million and $10.5 million as of June 30, 2018 and December 31, 2017, respectively, which combines current and long-term balances.

Cost of Revenue

Our cost of SaaS and license revenue primarily includes the amounts paid to wireless network providers and, to a lesser extent, the costs of running our network operation centers which are expensed as incurred, as well as royalty costs in connection with technology licensed from third-party providers. Our cost of SaaS and license revenue also includes our cost of software license revenue, which primarily includes the payroll and payroll-related costs of the department dedicated to providing service exclusively to those service providers that host the Connect platform. Our cost of software license revenue during the three and six months ended June 30, 2018 was $0.4 million and $0.9 million, respectively, as compared to $0.3 million and $0.4 million for the same periods in the prior year. Our cost of hardware and other revenue primarily includes cost of raw materials and amounts paid to our third-party manufacturer for production and fulfillment of our cellular radio modules and image sensors, and procurement costs for our video cameras, which we purchase from an original equipment manufacturer, and other devices. Our cost of hardware and other revenue also includes royalty costs in connection with technology licensed from third-party providers.

We record the cost of SaaS and license revenue as expenses are incurred, which corresponds to the delivery period of our services to our subscribers. We record the cost of hardware and other revenue when the hardware and other services are delivered to the service provider partner, which occurs when legal title transfers to the service provider partner. Our cost of revenue excludes amortization and depreciation.

Contract Asset and Contract Liability Balances

At contract inception, we assess the goods and services promised in our contracts with customers and identify a performance obligation for each distinct promise to transfer a good or service, or bundle of goods or services. To identify the performance obligations, we consider all of the goods or services promised in the contract, whether explicitly stated or implied based on customary business practices. We record a contract asset when we satisfy a performance obligation by transferring a promised good or service. Contract assets can be conditional or unconditional depending on whether another performance obligation must be satisfied before payment can be received. We receive payments from our service provider partners based on the billing schedule established in our contracts. All of the accounts receivable presented in the balance sheet represent unconditional rights to consideration. We do not have any assets from contracts containing conditional rights and we do not have any assets from satisfied performance obligations that have not been invoiced. Our contract assets consist of capitalized commission costs, which are discussed below in the "Costs to Obtain or Fulfill a Contract" section of Note 2.

The changes in our contract assets are as follows (in thousands):

	Three Months	Six Months

	Ended June 30, 2018	Ended June 30, 2018
Beginning of period balance	$2,953	$—
Commission costs capitalized in period	412	3,855
Amortization of capitalized commission costs	(486)	(976)
End of period balance	$2,879	$2,879

Contract liabilities include payments received in advance of performance under the contract, and are realized with the associated revenue recognized under the contract. All of the deferred revenue presented in the balance sheet represents contract liabilities resulting from advance cash receipts from customers or amounts billed in advance to customers from the sale of services. Changes in deferred revenue are due to our performance under the contract as well as to cash received from new contracts for which services have not been provided.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

The changes in our contract liabilities are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Beginning of period balance	$12,133	$12,983	$12,678	$12,625
Revenue deferred in period	891	1,025	1,481	2,315
Revenue recognized from amounts included in contract liabilities	(1,053)	(1,307)	(2,188)	(2,239)
End of period balance	$11,971	$12,701	$11,971	$12,701

The revenue recognized from amounts included in contract liabilities primarily relates to payments of activation fees as well as prepayment contracts with customers.

Costs to Obtain or Fulfill a Contract

We recognize an asset related to the costs incurred to obtain a contract only if we expect to recover those costs and we would not have incurred those costs if the contract had not been obtained. We recognize an asset from the costs incurred to fulfill a contract if the costs (i) are specifically identifiable to a contract, (ii) enhance resources that will be used in satisfying performance obligations in future and (iii) are expected to be recovered. Based on the policy above, we capitalize a portion of our commission costs as an incremental cost of obtaining a contract. When calculating the incremental cost of obtaining a contract, we exclude any commission costs related to metrics that could be satisfied without obtaining a contract, including training-related metrics. We amortize our commission costs over a period of three years, which is consistent with the period over which the products and services related to the commission are transferred to the customer. The three-year period was determined based on our review of historical enhancements and upgrades to our products and services. We applied the portfolio approach to account for the amortization of contract costs as each contract has similar characteristics.

The current portion of capitalized commission costs is included in other current assets within our condensed consolidated balance sheets. The non-current portion of capitalized commission costs is reflected in other assets within our condensed consolidated balance sheets. We amortized capitalized commission costs of $0.5 million and $1.0 million during the three and six months ended June 30, 2018, respectively. There were no amortized commission costs during the three and six months ended June 30, 2017.

We review the capitalized costs for impairment at least annually. Impairment exists if the carrying amount of the asset recognized from contract costs exceeds the remaining amount of consideration we expect to receive in exchange for providing the goods and services to which such asset relates, less the costs that relate directly to providing those good and services and that have not been recognized as an expense. We did not record an impairment loss on our capitalized commission costs or any other contract assets during the three and six months ended June 30, 2018 and 2017.

Recent Accounting Pronouncements

Adopted

Revenue from Contracts with Customers (Topic 606):

In May 2014, the Financing Accounting Standards Board, or FASB, and International Accounting Standards Board jointly issued Accounting Standards Update, or ASU, 2014-09, "Revenue from Contracts with Customers (Topic 606)," a new revenue recognition standard that provides a framework for addressing revenue issues, improves the comparability of revenue recognition practices across industries, provides useful information to users of financial statements through improved disclosure requirements and simplifies the presentation of financial statements. From March to December 2016, amendments to Topic 606 were issued to clarify numerous accounting topics, including, but not limited to: (i) the implementation guidance on principal versus agent considerations, (ii) the identification of performance obligations, (iii) the licensing implementation guidance, (iv) the objective of the collectability criterion, (v) the application of the variable consideration guidance and modified retrospective transition method, (vi) the way in which impairment testing is performed and (vii) the disclosure requirements for revenue recognized from performance obligations. This guidance permits the use of either a full retrospective method or a modified retrospective method. This guidance was effective beginning January 1, 2018.

On January 1, 2018, we adopted Topic 606 by applying the modified retrospective transition method to all of our contracts. Comparative information has not been restated and continues to be reported under the accounting standards in effect for the periods presented. The adoption of Topic 606 did not have a material impact on our revenue recognition policies, however, as a result of adopting the new standard, we changed our treatment of commissions paid to employees, which we previously expensed as incurred. Under the new standard, we capitalize a portion of our commission costs as an incremental cost of obtaining a contract and amortize our commission costs over a period of three years, which is consistent with the period over which the products and services related to the commission are transferred to the customer. Based on the results of our evaluation, the adoption of Topic 606 did not have a material impact on our condensed consolidated financial statements for the three and six months ended June 30, 2018. Additionally, the cumulative effect to the opening balance sheet on January 1, 2018 from the adoption of Topic 606 was not material.

Other Accounting Standards:

On May 10, 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718) - Scope of Modification Accounting," which amends the scope of modification accounting for share-based payment arrangements. The update provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Accounting Standards Codification, or ASC, Topic 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions and classification of the awards are the same immediately before and after the modification. The amendment is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. We adopted ASU 2017-09 during the first quarter of 2018 and the adoption of this ASU did not have a material impact on our financial statements and related disclosures.

On January 5, 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805) - Clarifying the Definition of a Business," which provides guidance to assist entities in evaluating when a set of transferred assets and activities is a business. To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. The amendment is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. We adopted ASU 2017-01 during the first quarter of 2018 and the adoption of this ASU did not have a material impact on our financial statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825-10)" and in February 2018, the FASB issued ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10)." These ASUs require entities to carry all investments in equity securities at fair value and recognize any changes in fair value in net income. Under these standards, equity investments that do not have readily determinable fair values are measured at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for an identical or a similar investment of the same issuer. The guidance in ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The guidance in ASU 2018-03 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. We adopted ASU 2016-01 and ASU 2018-03 in 2018 and the adoption of these ASUs did not have a material impact on our financial statements and related disclosures.

Not Yet Adopted

On June 16, 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326)," which provides guidance designed to provide financial statement users with more information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. When determining such expected credit losses, the guidance requires companies to apply a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendment is effective on a modified retrospective basis for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted for fiscal years and interim periods beginning after December 15, 2018. We are currently assessing the impact this pronouncement may have on our trade receivables and notes receivables.

On February 25, 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)” or Topic 842, which requires lessees to recognize operating and financing lease liabilities and corresponding right-of-use assets on the balance sheet. The update also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. The amendments in this update are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. We plan to adopt Topic 842 effective January 1, 2019. The update must be adopted using a modified retrospective approach. In July 2018, the FASB amended the update to allow entities to apply the transition requirements of Topic 842 at the adoption date rather than at the beginning of the earliest comparative period presented. We plan to use this optional transition method, which will require us to record the effect of initially applying Topic 842 as a cumulative-effect adjustment to retained earnings on January 1, 2019.

We plan to use the package of practical expedients for the adoption of Topic 842, which will allow us not to reassess: (i) whether any expired or existing contracts are or contain leases, (ii) lease classification for any expired or existing leases and (iii) whether initial direct costs for any existing leases qualify for capitalization under Topic 842. Additionally, we plan to use the hindsight practical expedient when determining the lease term and assessing impairment of right-of-use assets. While we are still evaluating the impact the update will have on our consolidated financial statements, we expect the adoption of Topic 842 will

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

result in the recognition of right-of-use assets and lease liabilities within the consolidated balance sheets, which may be material. Additionally, we do not expect the adoption of Topic 842 to have a material impact on our consolidated statements of operations.

Note 3. Accounts Receivable, Net

The components of accounts receivable, net are as follows (in thousands):

	June 30, 2018	December 31, 2017
Accounts receivable	$56,033	$ 44,554
Allowance for doubtful accounts	(1,380)	(1,449)
Allowance for product returns	(2,100)	(2,471)
Accounts receivable, net	$52,553	$ 40,634

For each of the three and six months ended June 30, 2018, we recorded a provision for doubtful accounts of less than $0.1 million. For the three months ended June 30, 2017, we recorded a reduction to the provision for doubtful accounts of $0.1 million. For the six months ended June 30, 2017, we recorded a provision for doubtful accounts of less than $0.1 million.

For each of the three and six months ended June 30, 2018, we recorded a reserve for product returns in our hardware and other revenue of $0.2 million, as compared to $0.6 million and $1.1 million for the same periods in the prior year, respectively. Historically, we have not experienced write-offs for uncollectible accounts or sales returns that have differed significantly from our estimates.

Note 4. Inventory, Net

The components of inventory, net are as follows (in thousands):

	June 30, 2018	December 31, 2017
Raw materials	$7,140	$ 7,484
Finished goods	7,578	6,693
Total inventory, net	$14,718	$ 14,177

Note 5. Acquisitions

Connect and Piper Business Units from Icontrol Networks, Inc.

On March 8, 2017, in accordance with the asset purchase agreement we entered into with Icontrol Networks, Inc., or Icontrol, on June 23, 2016, we acquired certain assets and assumed certain liabilities of the Connect line of business and all of the outstanding equity interests of the two subsidiaries through which Icontrol conducted its Piper line of business, or the Acquisition. Connect provides an interactive security and home automation platform for service providers. Piper provides an all-in-one video and home automation hub. We expect the addition of new technology infrastructure, talent, key relationships and hardware devices to help accelerate our development of intelligent, data-driven smart residential and commercial property services.

The cash consideration was $148.5 million, after the estimated working capital adjustment, of which $14.5 million was deposited in escrow and was released in accordance with the asset purchase agreement upon the finalization of indemnification obligations of Icontrol stockholders and the final determination of closing working capital. We used $81.5 million of cash on hand and drew $67.0 million under our senior line of credit with Silicon Valley Bank, or SVB, and a syndicate of lenders to fund the Acquisition.

The Acquisition also included non-cash consideration. In accordance with the terms of the asset purchase agreement, we were obligated to assume the Icontrol 2013 Equity Incentive Plan and Icontrol 2003 Stock Plan, or collectively, the Icontrol Plans, and converted the 2,001,387 unvested employee stock options into 70,406 Alarm.com stock options using a conversion ratio stated in the agreement to convert the original exercise price and number of options. The fair value of the unvested stock options on the date of the Acquisition was $1.7 million calculated using a Black-Scholes model with a volatility and risk-free interest rate over the expected term of the options and the closing price of the Alarm.com common stock on the date of acquisition. We applied our graded vesting accounting policy to the fair value of these assumed options and determined $1.4 million of the fair value was attributable to pre-combination services and was included as a component of total purchase consideration. The

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

remaining $0.3 million of the fair value was determined to be attributable to post-combination services and will be recognized over the remaining service periods of the stock options.

The following table summarizes the assumptions used for estimating the fair value of stock options assumed from the Connect business unit of Icontrol:

	Six Months Ended June 30, 2017
Volatility	42.7 - 44.4%
Expected term	2.5 - 5.0 years
Risk-free interest rate	1.4 - 2.0%
Dividend rate	— %

The table below sets forth the purchase consideration and the fair value allocation of the tangible and intangible net assets acquired (in thousands):

	March 8, 2017
Calculation of Purchase Consideration:	
Cash paid, net of working capital adjustment	$148,500
Assumed stock options	1,375
Total consideration	$149,875
Estimated Tangible and Intangible Net Assets:	
Cash	$211
Accounts receivable	11,421
Current assets	883
Long-term assets	4,446
Customer relationships	93,260
Developed technology	4,770
Trade name	170
Current liabilities	(1,608)
Long-term liabilities	(288)
Goodwill	36,610
Total estimated tangible and intangible net assets	$149,875

Goodwill of $36.6 million reflects the value of acquired workforce and synergies we expect to achieve from integrating support for Connect's security service providers and for the Connect platform. The goodwill will be deductible for tax purposes. We allocated goodwill to reporting units based on expected benefit from our synergies, and have allocated the goodwill to the Alarm.com segment.

The purchase price allocation for the Acquisition was finalized during the third quarter of 2017. The final fair value of the assets and liabilities related to the Acquisition reflects an increase of $0.1 million in tangible assets, net and a decrease of $0.1 million in goodwill based on working capital adjustments identified by us.

Fair Value of Net Assets Acquired and Intangibles

In accordance with ASC 805, the business units acquired in the Acquisition constituted a business and the assets and liabilities were recorded at their respective fair values as of March 8, 2017. We developed our estimate of the fair value of intangible net assets using a multi-period excess earnings method for customer relationships, the relief from royalty method for the developed technology and the relief from royalty method for the trade name.

Customer Relationships

We recorded the customer relationships intangible separately from goodwill based on determination of the length, strength and contractual nature of the relationship that Connect shared with its customers. We valued two groups of customer relationships using the multi-period excess earnings method, an income approach. We used several assumptions in the income approach, including attrition and renewal rate, margin and discount rate. We are amortizing the first customer relationship, valued at $92.5 million, on an attribution basis derived from the discounted cash flows of the model over an estimated useful life of twelve years and the second group of customer relationships, valued at $0.8 million, on the same basis, over an estimated useful life of four years.

Developed Technology

Developed technology primarily consists of intellectual property of proprietary software that is marketed for sale. The Connect platform is software for interactive security, automation and related solutions that is typically deployed and operated by the service provider in its own network operations center. We valued the developed technology by applying the relief from royalty method, an income approach. We used several assumptions in the relief from royalty method, which included royalty rate and discount rate. We are amortizing the Connect developed technology, valued at $4.4 million, on an attribution method based on the discounted cash flows of the model over an estimated useful life of three years. Other developed technologies, valued at $0.3 million, were also acquired.

Trade Name

We determined that there was no fair value for the Connect trade name as the largest service provider partner for Connect had re-branded the interactive security and automation platform and marketed it under the service provider partner's own name. We valued the other trade names acquired using a relief from royalty method. We used several assumptions in the income approach, including royalty and discount rates. We are amortizing the other trade names, valued at $0.2 million, on an attribution basis derived from the discounted cash flows of the model over an estimated useful life of three years.

Deferred Tax Asset

The equity interests in the subsidiaries we acquired provided for a carryover tax basis in goodwill and intangible assets that arose from a previous acquisition. We recorded a deferred tax asset of $4.1 million that represents the excess of the carryover tax basis in those previously acquired goodwill and intangible assets over the fair value of goodwill and intangible assets we recorded on the date of the Acquisition.

ObjectVideo

On January 1, 2017, in accordance with an asset purchase agreement, we acquired certain assets of ObjectVideo, Inc., or ObjectVideo, that constituted a business now called ObjectVideo Labs, LLC, or ObjectVideo Labs, including products, technology portfolio and engineering team. ObjectVideo is a pioneer in the fields of video analytics and computer vision with technology that extracts meaning and intelligence from video streams in real-time to enable object tracking, pattern recognition and activity identification. We anticipate that the ObjectVideo Labs engineering team's capabilities and expertise will accelerate our research and development of video services and video analytic applications. In addition, ObjectVideo Labs will continue to perform advanced research and engineering services for the federal government. The consideration included $6.0 million of cash paid at closing.

The table below sets forth the purchase consideration and the fair value allocation of the tangible and intangible net assets acquired (in thousands):

	January 1, 2017
Calculation of Purchase Consideration:	
Cash paid, net of working capital adjustment	$ 6,000
Estimated Tangible and Intangible Net Assets:	
Developed technology	$ 3,800
Current liabilities	(58)
Goodwill	2,258
Total estimated tangible and intangible net assets	$ 6,000

Goodwill of $2.3 million reflects the value of acquired workforce and expected synergies from pairing ObjectVideo Labs' video analytics capabilities with our offerings. The goodwill will be deductible for tax purposes.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

The purchase price allocation for the ObjectVideo Labs acquisition was finalized during the third quarter of 2017. The final fair value of the assets and liabilities related to the ObjectVideo Labs acquisition reflects an increase of $0.4 million in developed technology and a decrease of $0.4 million in goodwill as well as a corresponding change to amortization of the developed technology based on our use of the replacement cost method to value the developed technology.

Fair Value of Net Assets Acquired and Intangibles

In accordance with ASC 805, the assets and liabilities of ObjectVideo Labs we acquired were recorded at their respective fair values as of January 1, 2017, the date of the acquisition. We developed our estimate of the fair value of intangible assets using the replacement cost method for the developed technology.

Developed Technology

Developed technology recorded separately from goodwill consists of intellectual property such as proprietary software used internally for revenue producing activities. ObjectVideo Labs proprietary software consists of source code and video analytics testing programs used internally to provide video analytics consulting services and research and development to customers and for the SaaS Alarm.com platform. We valued the developed technology by applying the replacement cost method. We used several assumptions in this cost approach, which included analyzing costs that a company would expect to incur to recreate an asset of equivalent utility. We are amortizing the developed technology, valued at $3.8 million, on a straight-line basis over an estimated useful life of two years which coincides with the rapidly developing technology of video analytics.

Unaudited Pro Forma Information

The following unaudited pro forma data is presented as if the Acquisition and ObjectVideo Labs were included in our historical consolidated statements of operations beginning January 1, 2016. These pro forma results do not necessarily represent what would have occurred if all the business combinations had taken place on January 1, 2016, nor do they represent the results that may occur in the future.

This pro forma financial information includes our historical financial statements and those of our business combinations with the following adjustments: (i) we adjusted the pro forma amounts for income taxes, (ii) we applied interest expense as if the additional borrowing for the acquisitions were as of January 1, 2016, (iii) we adjusted for amortization expense assuming the fair value adjustments to intangible assets had been applied beginning January 1, 2016, and (iv) we adjusted for transaction fees incurred and reclassified them to January 1, 2016.

The pro forma adjustments were based on available information and upon assumptions that we believe are reasonable to reflect the impact of these acquisitions on our historical financial information on a supplemental pro forma basis, as follows (in thousands):

	Pro Forma Six Months Ended June 30, 2017

Revenue	$171,252
Net income	21,445
Net income per diluted share	$0.44

Business Combinations in Operations

The operations of each of the business combinations discussed above were included in the condensed consolidated financial statements as of each of their respective acquisition dates. The following table presents the revenue and earnings of the business combinations in the year of acquisition as reported within the condensed consolidated financial statements (in thousands):

	Six Months Ended June 30, 2017
Revenue	$12,252
Net loss	(3,522)

For the Acquisition, we included the results of Connect's operations since its acquisition date in the Alarm.com segment and the results of Piper's operations since its acquisition date in the Other segment. We included the results of ObjectVideo Labs operations since its acquisition date in the Alarm.com segment.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

Note 6. Goodwill and Intangible Assets, Net

The changes in goodwill by reportable segment are outlined below (in thousands):

	Alarm.com	Other	Total
Balance as of January 1, 2018	$ 63,591	$ —	$63,591
Goodwill acquired	—	—	—
Balance as of June 30, 2018	$ 63,591	$ —	$63,591

There were no impairments of goodwill during the three and six months ended June 30, 2018 and 2017.

The following table reflects changes in the net carrying amount of the components of intangible assets (in thousands):

	Customer Relationships	Developed Technology	Trade Name	Total
Balance as of January 1, 2018	$ 88,526	$ 5,532	$ 228	$94,286
Amortization	(5,631)	(1,935)	(51)	(7,617)
Balance as of June 30, 2018	$ 82,895	$ 3,597	$ 177	$86,669

We recorded $3.8 million and $7.6 million of amortization related to our intangible assets for the three and six months ended June 30, 2018, respectively, as compared to $3.5 million and $5.0 million for the same periods in the prior year. There were no impairments of long-lived intangible assets during the three and six months ended June 30, 2018 and 2017.

The following tables reflect the weighted average remaining life and carrying value of finite-lived intangible assets (in thousands):

	June 30, 2018			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted-Average Remaining Life
Customer relationships	$103,926	$ (21,031)	$82,895	10.4
Developed technology	13,959	(10,362)	3,597	1.8
Trade name	1,084	(907)	177	2.7
Other	234	(234)	—	—
Total intangible assets	$119,203	$ (32,534)	$86,669	

	December 31, 2017			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted-Average Remaining Life
Customer relationships	$103,926	$ (15,400)	$88,526	10.8
Developed technology	13,959	(8,427)	5,532	2.1
Trade name	1,084	(856)	228	3.3
Other	234	(234)	—	—

Total intangible assets	$119,203	$ (24,917)	$94,286

15

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

Note 7. Other Assets

Patent Licenses

From time to time, we enter into agreements to license patents. The carrying value, net of amortization, was $2.1 million and $2.4 million as of June 30, 2018 and December 31, 2017, respectively. As of June 30, 2018 and December 31, 2017, $0.4 million and $0.5 million of patent licenses were included in other current assets and $1.7 million and $1.9 million of patent licenses were included in other assets, respectively. We have $4.9 million of historical cost in patent licenses related to such agreements. We are amortizing the patent licenses over the estimated useful lives of the patents, which range from 3 years to 11 years. Amortization expense on patent licenses was $0.2 million and $0.3 million for the three and six months ended June 30, 2018, respectively, as compared to $0.2 million and $0.4 million for the same periods in the prior year, which is included in cost of SaaS and license revenue in our condensed consolidated statements of operations.

Loan to a Distribution Partner

In September 2016, we entered into dealer and loan agreements with a distribution partner. The dealer agreement enables the distribution partner to resell our SaaS services and hardware to their subscribers. Under the loan agreements, we agreed to loan the distribution partner up to $4.0 million, collateralized by all assets owned by the distribution partner. The advance period for the loan was amended in August 2017 to begin each year on September 1 and end each year on December 31. Interest on the outstanding principal accrued at a rate per annum equal to the greater of 6.0% or the Eurodollar Base Rate, or LIBOR, plus 4.0%, as determined on the first date of each annual advance period. The repayment of principal and accrued interest was due in three installments beginning in July and ending in August following the advance period. The term date of the loan was August 31, 2019; however, the borrower had the option to extend the term of the loan for two successive terms of one year each.

In May 2018, the loan agreement with our distribution partner was amended to convert the entire $4.0 million note receivable outstanding into a $4.0 million term loan. The term loan matures on July 31, 2022 and requires annual principal repayments of $1.0 million on July 31 of each year, commencing on July 31, 2019. The term loan also requires monthly interest payments, with interest accruing on the outstanding principal balance at a rate per annum equal to 6.0% through June 30, 2018 and a rate per annum equal to the LIBOR rate on the first of any interest period plus 7.0% beginning on July 1, 2018. The $4.0 million note receivable balance was included in other assets and other current assets in our condensed consolidated balance sheets as of June 30, 2018 and December 31, 2017, respectively.

In April 2017, we entered into a subordinated credit agreement with an affiliated entity of the distribution partner and loaned the affiliated entity $3.0 million, with a maturity date of November 21, 2022. Interest on the outstanding principal balance accrues at a rate of 8.5% per annum and requires monthly interest payments. The $3.0 million loan receivable balance was included in other assets as of June 30, 2018 and December 31, 2017.

For the three and six months ended June 30, 2018, we recognized $0.5 million and $0.7 million of revenue from the distribution partners associated with these loans, respectively, as compared to $0.6 million and $0.8 million for the same periods in the prior year.

Prepaid Expenses

As of June 30, 2018, $13.3 million of prepaid expenses were included in other current assets and were primarily comprised of prepayments for inventory. As of December 31, 2017, $3.8 million of prepaid expenses were included in other current assets. In April 2018, we made a prepayment of $5.2 million for long lead-time parts related to our inventory.

Note 8. Fair Value Measurements

The following table presents our assets and liabilities measured at fair value on a recurring basis (in thousands):

	Fair Value Measurements on a Recurring Basis as of June 30, 2018			
Fair value measurements in:	Level 1	Level 2	Level 3	Total
Assets:				
Money market account	$67,089	$ —	$—	$67,089
Total	$67,089	$ —	$—	$67,089
Liabilities:				
Subsidiary unit awards	$—	$ —	$389	$389
Total	$—	$ —	$389	$389

16

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

	Fair Value Measurements on a Recurring Basis as of December 31, 2017			
Fair value measurements in:	Level 1	Level 2	Level 3	Total
Assets:				
Money market account	$65,620	$ —	$—	$65,620
Total	$65,620	$ —	$—	$65,620
Liabilities:				
Subsidiary unit awards	$—	$ —	$3,160	$3,160
Total	$—	$ —	$3,160	$3,160

The following table summarizes the change in fair value of the Level 3 liabilities for subsidiary unit awards with significant unobservable inputs (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Beginning of period balance	$389	$2,978	$3,160	$2,768
Total losses / (gains) included in earnings	—	(66)	31	144
Settlements	—	—	(2,802)	—
End of period balance	$389	$2,912	$389	$2,912

The money market account is included in our cash and cash equivalents in our condensed consolidated balance sheets. Our money market assets are valued using quoted prices in active markets.

The liability for the subsidiary unit awards relates to agreements established with employees of our subsidiaries for cash awards contingent upon the subsidiary companies meeting certain financial milestones such as revenue, working capital, EBITDA and EBITDA margin. We account for these subsidiary awards using fair value and establish liabilities for the future payment for the repurchase of subsidiary units under the terms of the agreements based on estimating revenue, working capital, EBITDA and EBITDA margin of the subsidiary units over the periods of the awards through the anticipated repurchase dates. We estimated the fair value of each liability by using a Monte Carlo simulation model for determining each of the projected measures by using an expected distribution of potential outcomes. The fair value of each liability is calculated with thousands of projected outcomes, the results of which are averaged and then discounted to estimate the present value. At each reporting date until the respective payment dates, we will remeasure these liabilities, using the same valuation approach based on the applicable subsidiary's revenue, an unobservable input, and we will record any changes in the employee's compensation expense. Some of the awards are subject to the employees' continued employment and therefore recorded on a straight-line basis over the remaining service period. During the six months ended June 30, 2018, we settled $2.8 million of the liability related to the subsidiary unit awards. The remaining liability balances are included in either accounts payable, accrued expenses and other current liabilities or other liabilities in our condensed consolidated balance sheets (see Note 10).

We monitor the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. There were no transfers between Levels 1, 2 or 3 during the three and six months ended June 30, 2018 and 2017. We also monitor the value of the investments for other-than-temporary impairment on a quarterly basis. No other-than-temporary impairments occurred during the three and six months ended June 30, 2018 and 2017.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

Note 9. Liabilities

The components of accounts payable, accrued expenses and other current liabilities are as follows (in thousands):

	June 30, 2018	December 31, 2017
Accounts payable	$21,519	$ 17,008
Accrued expenses	7,562	4,301
Subsidiary unit awards	225	2,802
Other current liabilities	2,824	4,973
Accounts payable, accrued expenses and other current liabilities	$32,130	$ 29,084

The components of other liabilities are as follows (in thousands):

	June 30, 2018	December 31, 2017
Deferred rent	$11,783	$ 12,279
Other liabilities	1,658	1,646
Other liabilities	$13,441	$ 13,925

Note 10. Debt, Commitments and Contingencies

The debt, commitments and contingencies described below would require us, or our subsidiaries, to make payments to third parties under certain circumstances.

Debt

On October 6, 2017, we entered into a $125.0 million senior secured revolving credit facility, or the 2017 Facility, with SVB, as administrative agent, PNC Bank, National Association, as documentation agent, and a syndicate of lenders. Upon entry into the 2017 Facility, we borrowed $72.0 million, which was used to repay the previously outstanding balance under our previous credit facility. The 2017 Facility matures in October 2022 and includes an option to further increase the borrowing capacity to $175.0 million with the consent of the lenders. Costs incurred in connection with the 2017 Facility were capitalized and are being amortized as interest expense over the term of the 2017 Facility. The 2017 Facility is secured by substantially all of our assets, including our intellectual property. During the three and six months ended June 30, 2018, we repaid $1.0 million and $2.0 million of the outstanding balance of the 2017 Facility, respectively, as compared to $1.0 million repaid during the same periods in the prior year.

The outstanding principal balance on the 2017 Facility accrues interest at a rate equal to, at our option, either (1) LIBOR, plus an applicable margin based on our consolidated leverage ratio, or (2) the highest of (a) the Wall Street Journal prime rate, (b) the Federal Funds rate plus 0.50%, or (c) LIBOR plus 1.00% plus an applicable margin based on our consolidated leverage ratio. For the three and six months ended June 30, 2018, we elected for the outstanding principal balance to accrue interest at LIBOR plus 1.50%, LIBOR plus 1.75%, LIBOR plus 2.00%, and LIBOR plus 2.50% when our consolidated leverage ratio is less than 1.00:1.00, greater than or equal to 1.00:1.00 but less than 2.00:1.00, greater than or equal to 2.00:1.00 but less than 3.00:1.00 and greater than or equal to 3.00:1.00, respectively. The 2017 Facility also carries an unused line commitment fee of 0.20%. For the six months ended June 30, 2018, the effective interest rate on the credit facilities was 4.00%, as compared to 4.65% for the same period in the prior year.

The carrying value of the 2017 Facility was $69.0 million and $71.0 million as of June 30, 2018 and December 31, 2017, respectively. The 2017 Facility includes a variable interest rate that approximates market rates and, as such, we classified the liability as Level 2 within the fair value hierarchy and determined that the carrying amount of the 2017 Facility approximated its fair value as of June 30, 2018 and December 31, 2017. The 2017 Facility contains various financial and other covenants that require us to maintain a maximum consolidated leverage ratio not to exceed 3.50:1.00 and a consolidated fixed charge coverage ratio of at least 1.25:1.00. As of June 30, 2018, we were in compliance with all financial and non-financial covenants and there were no events of default.

Commitments and Contingencies

Repurchase of Subsidiary Units

In 2011, we formed a subsidiary that offers to professional residential property management and vacation rental management companies technology solutions for remote monitoring and control of properties, including access control and energy management. Since its formation, we granted an award of subsidiary stock to the founder and president. The vesting of the award is based upon the subsidiary meeting certain minimum financial targets from the date of commercial availability, which was determined to be June 1, 2013, until the fourth anniversary. In 2016, we amended the term of the award, extending the valuation date for the first payment in cash to December 31, 2017, amending the financial targets and allowing for payments in cash based on the future collection of financed customer receivables from 2018 to 2020 that existed as of the valuation date. During the six months ended June 30, 2018, we settled $2.8 million of the liability related to the subsidiary unit awards. We recorded a liability of $0.2 million in accounts payable, accrued expenses and other current liabilities and $0.2 million in other liabilities related to this commitment in our condensed consolidated balance sheet as of June 30, 2018. We recorded a liability of $2.8 million in accounts payable, accrued expenses and other current liabilities and a liability of $0.4 million in other liabilities related to this commitment in our condensed consolidated balance sheet as of December 31, 2017.

At each reporting date until the respective payment dates, we will remeasure these liabilities, and we will record any changes in fair value in general and administrative expense (see Note 8).

Leases

We lease office space and office equipment under non-cancelable operating leases with various expiration dates through 2026. We recognize rent expense for lease payments on a straight-line basis over the expected lease term and amortize tenant improvement allowances over the term of the lease. In August 2014, we signed a lease for new office space in Tysons, Virginia, where we relocated our headquarters in February 2016. The lease term ends in 2026 and includes a five-year renewal option, an $8.0 million tenant improvement allowance and scheduled rent increases. During 2016, we entered into amendments to this lease which provided for 30,662 square feet of additional office space and an additional $1.7 million in tenant improvement allowance. We took possession of the additional space in February 2017 and we were allowed to utilize the tenant improvement allowance for design prior to moving into the space. The entire $9.7 million tenant improvement allowance was utilized as of December 31, 2017.

For the three and six months ended June 30, 2018, rent expense was $1.7 million and $3.4 million, respectively, as compared to $1.6 million and $2.9 million for the same periods in the prior year.

Indemnification Agreements

We have various agreements that may obligate us to indemnify the other party to the agreement with respect to certain matters. Generally, these indemnification provisions are included in contracts arising in the normal course of business. Although we cannot predict the maximum potential amount of future payments that may become due under these indemnification agreements, we do not believe any potential liability that might arise from such indemnity provisions is probable or material.

Letters of Credit

As of June 30, 2018 and December 31, 2017, we had no outstanding letters of credit under our 2017 Facility.

Legal Proceedings

On June 2, 2015, Vivint, Inc., or Vivint, filed a lawsuit against us in U.S. District Court, District of Utah, alleging that our technology directly and indirectly infringes six patents that Vivint purchased. Vivint is seeking permanent injunctions, enhanced damages and attorneys' fees. We answered the complaint on July 23, 2015. Among other things, we asserted defenses based on non-infringement and invalidity of the patents in question. On August 19, 2016, the U.S. District Court, District of Utah stayed the litigation pending inter partes review, or IPR, by the U.S. Patent Trial and Appeal Board, or PTAB, of five of the patents in suit. In March 2017, the PTAB issued final written decisions relating to two patents finding all challenged claims unpatentable. In May 2017, the PTAB issued final written decisions relating to the remaining patents that found certain claims unpatentable, while certain other claims were not found to be unpatentable. Vivint has appealed the decisions to the U.S. Court of Appeals for the Federal Circuit, and we have cross-appealed. The U.S. District Court, District of Utah lifted the stay on the litigation on June 26, 2017, and Vivint is proceeding with its case on four of the six patents in its complaint. Fact discovery is scheduled to close on or about August 31, 2018, and no trial date has been set. In September 2017, the U.S. Patent and Trademark Office ordered ex parte reexaminations of certain claims of two of the remaining patents in suit, at our request. On July 13, 2018, the U.S. Court of Appeals for the Federal Circuit affirmed the PTAB’s March 2017 decision, which invalidated all challenged claims of U.S. Patent No. 7,884,713.

Should Vivint prevail on its claims that one or more elements of our solution infringe one or more of its patents, we could be required to pay damages of Vivint's lost profits and/or a reasonable royalty for sales of our solution, enjoined from making, using and selling our solution if a license or other right to continue selling such elements is not made available to us or we are unable to design around such patents, and required to pay ongoing royalties and comply with unfavorable terms if such a license is made available to us. The outcome of the legal claim and proceeding against us cannot be predicted with certainty. We believe we have valid defenses to Vivint's claims. Based on currently available information, we determined a loss is not probable or reasonably estimable at this time.

On December 30, 2015, a putative class action lawsuit was filed against us in the U.S. District Court for the Northern District of California, alleging violations of the Telephone Consumer Protection Act, or TCPA. The complaint does not allege that Alarm.com itself violated the TCPA, but instead seeks to hold us responsible for the marketing activities of our service provider partners under principles of agency and vicarious liability. Specifically, the plaintiffs seek to hold us liable for telemarketing calls made by one of our service providers, as well as calls made by one of its sub-dealer agents, that purportedly violated the TCPA's provisions concerning use of Automatic Telephone Dialing Systems ("ATDS") and placing calls to numbers listed on the national Do-Not-Call ("DNC") registry. The complaint seeks monetary damages under the TCPA, injunctive relief, and other relief, including attorneys' fees. On May 5, 2017, the court granted plaintiffs' motion for class certification, and certified two plaintiff classes: a DNC class and an ATDS class. Plaintiffs claim that 393,762 individuals received 3,002,373 telephone calls in violation of the TCPA's DNC-related provisions, and that 22,055 individuals received 119,484 telephone calls in violation of the TCPA's ATDS-related provisions. Discovery is closed, and the matter remains pending in the U.S. District Court for the Northern District of California. The court has denied the parties' cross-motions for summary judgment, and based on the current schedule, we anticipate a trial will take place in October 2018.

The outcome of this legal claim and proceeding against us cannot be predicted with certainty. While we believe we have valid defenses to plaintiffs' claims, a negative outcome could result in a material adverse effect on our business, financial condition, cash flows and results of operations. If plaintiffs' claims are successful, a jury could award damages of up to $500 per telephone call made to class members on the Do Not Call Registry. Calls made in violation of the ATDS-related provisions are subject to statutory damages of $500 per call. Both ATDS- and DNC-related damages may be trebled if the violations are found to be knowing or willful. Should we decide to appeal an adverse verdict, we would be required to post a bond in the amount of that verdict to stay execution of the judgment while the appeal is pending, which may not be available on reasonable terms, if at all. Based on currently available information, we determined a loss is not reasonably estimable at this time.

On August 14, 2017, Alarm.com filed a lawsuit against ABS Capital Partners, Inc., ABS Partners V, LLC, ABS Partners VII, LLC, and Ralph Terkowitz in the Delaware Court of Chancery, or the Chancery Court. The complaint sought declaratory and injunctive relief preventing the defendants from using Alarm.com's confidential information and trade secrets to compete with Alarm.com, and preventing the defendants from executing their planned transaction to invest in two companies (ipDatatel, LLC, or ipDatatel, and Resolution Products, Inc., or Resolution Products). The complaint alleged claims of breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, misappropriation of trade secrets, and misappropriation of confidential information, in connection with the defendants' planned investment. On September 22, 2017, Alarm.com filed an amended complaint against ABS Capital Partners, Inc., ABS Partners V, LLC, and ABS Partners VII, LLC, alleging claims for misappropriation of trade secrets and misappropriation of confidential information. The amended complaint seeks damages, declaratory relief, and injunctive relief enjoining ABS Capital Partners, Inc., ABS Partners V, LLC, and ABS Partners VII, LLC from using Alarm.com's trade secrets and confidential information to compete with Alarm.com. On October 6, 2017, the defendants filed a motion to dismiss the lawsuit. On June 15, 2018, the Chancery Court dismissed our complaint. On July 13, 2018, Alarm.com filed a Notice of Appeal with the Delaware Supreme Court.

On August 24, 2017, Alarm.com Incorporated and its wholly owned subsidiary ICN Acquisition, LLC, filed a patent infringement complaint against ipDatatel, in the United States District Court for the Eastern District of Texas. The parties subsequently stipulated to transfer the case to the Southern District of Texas. The complaint seeks injunctive relief to stop the further sale of the infringing ipDatatel’s products and systems, and damages for the infringement of Alarm.com’s patents. The complaint asserts that the technology in the ipDatatel products infringe one or more claims of Alarm.com’s patents: United States Patent Numbers 7,113,090; 7,633,385; 7,956,736; 8,478,871; and 9,141,276. If the litigation is successful, Alarm.com will be entitled to receive monetary damages, injunctive relief, and any other relief, including attorneys' fees, from ipDatatel. The Court has scheduled a claim construction hearing for September 2018 and commencement of trial in August 2019. ipDatatel has not yet answered the complaint or asserted counterclaims and defenses. ipDatatel's motion for dismissal based on alleged patent ineligibility as to each patent in suit was denied without prejudice. On July 26, 2018, ipDatatel answered the complaint by denying the patent infringement allegations and asserting several affirmative defenses, including invalidity and unenforceability. ipDatatel also asserted antitrust counterclaims based on alleged inequitable conduct in connection with the prosecution of one or more patents-in-suit.

On April 25, 2017, Alarm.com Incorporated and its wholly owned subsidiary ICN Acquisition, LLC, filed a patent infringement complaint against Protect America, Inc., or Protect America, and SecureNet Technologies, LLC, or SecureNet, in the United States District Court for the Eastern District of Virginia. The complaint seeks injunctive relief to stop the further sale of the infringing Protect America and SecureNet products and systems, and damages for the infringement of Alarm.com’s patents. The complaint asserts that the technology in the Protect America and SecureNet Alarm Systems products infringe one or more claims of Alarm.com’s patents: United States Patent Numbers 7,113,090; 7,633,385; 8,395,494; 8,493,202; 8,612,591; 8,860,804; and 9,141,276. If the litigation is successful, Alarm.com will be entitled to receive monetary damages, injunctive relief, and any other relief, including attorneys' fees, from Protect America and SecureNet. In June 2017, Alarm.com filed an amended complaint against Protect America only and voluntarily dismissed SecureNet from the suit, reserving the right to refile. In September 2017, Alarm.com voluntarily dismissed the amended complaint in the United States District Court of the Eastern District of Virginia and refiled a complaint against Protect America, with substantially the same allegations, in the United States District Court of the Eastern District of Texas. Protect America has not yet answered the complaint or asserted counterclaims and defenses. Protect America has moved for dismissal or transfer to the Western District of Texas based on allegedly improper venue. The parties subsequently stipulated to transfer the case to the Western District of Texas. The Court has not yet entered a scheduling order.

In September 2014, Icontrol filed a Complaint in the United States District Court, District of Delaware, asserting that SecureNet infringes certain U.S. Patents owned by Icontrol, patents now owned by Alarm.com through a subsidiary. In March 2015, Icontrol voluntarily agreed to dismiss the case, reserving the right to refile. In September 2015, Icontrol refiled the case against SecureNet in the same district court alleging infringement of some of the same patents. SecureNet filed petitions for inter partes review of the patents-in-suit before the PTAB. Proceedings as to one of the patents in suit (United States Patent Number 7,855,635) was instituted, resulting in the cancellation of some, but not all, claims of that patent. That decision is currently before the Court of Appeals for the Federal Circuit. The PTAB has rejected the remaining applications for inter partes review, and SecureNet requested rehearing of the rejection as to one of the patents in suit, which request has been rejected by the PTAB. In April 2018, the Court issued an order construing certain patent claim terms. The Court has scheduled commencement of trial in February 2019.

On March 29, 2018, a putative class action lawsuit was filed against us by Nick Fisher in the U.S. District Court for the Northern District of Illinois, alleging violations of the TCPA, and the Telemarketing And Consumer Fraud and Abuse Prevention Act, or TCFAPA. The complaint alleges that Alarm.com and another defendant, Nortek Security & Control LLC, violated the TCPA and TCFAPA through purportedly unauthorized telephone calls to Fisher, and seeks to hold us responsible for the alleged calls, including under principles of agency and vicarious liability. The complaint seeks monetary damages under the TCPA and TCFAPA, injunctive relief, and other relief, including attorneys' fees. We answered the complaint and filed a motion to dismiss the complaint on June 18, 2018. The matter remains pending. Based on currently available information, we determined a loss is not probable or reasonably estimable at this time.

In addition, we may be a party to litigation and subject to claims incident to the ordinary course of business. Although the results of litigation and claims cannot be predicted with certainty, we currently believe that the final outcome of these ordinary course matters will not have a material adverse effect on our business.

Other than the preceding matters, we are not a party to any lawsuit or proceeding that, in the opinion of management, is reasonably possible or probable of having a material adverse effect on our financial position, results of operations or cash flows. We reserve for contingent liabilities based on ASC 450, “Contingencies,” when it is determined that a liability, inclusive of defense costs, is probable and reasonably estimable. Litigation is subject to many factors that are difficult to predict, so there can be no assurance that, in the event of a material unfavorable result in one or more claims, we will not incur material costs.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

Note 11. Stock-Based Compensation

Stock-based compensation expense is included in the following line items in the condensed consolidated statements of operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Sales and marketing	$319	$65	$554	$178
General and administrative	1,481	755	2,509	1,324
Research and development	1,744	1,095	3,150	1,726
Total stock-based compensation expense	$3,544	$1,915	$6,213	$3,228

The following table summarizes the components of non-cash stock-based compensation expense (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Stock options and assumed options	$1,088	$1,083	$1,816	$2,066
Restricted stock units	2,415	805	4,315	1,093
Restricted stock awards	—	—	1	19
Employee stock purchase plan	41	27	81	50
Total stock-based compensation expense	$3,544	$1,915	$6,213	$3,228
Tax benefit from stock-based awards	$3,492	$4,369	$3,941	$5,586

We granted an aggregate of 148,500 and 176,500 stock options pursuant to our 2015 Equity Incentive Plan, or 2015 Plan, during the three and six months ended June 30, 2018, respectively, as compared to an aggregate of 181,400 and 237,550 stock options for the same periods in the prior year. There were 381,119 and 439,864 stock options exercised during the three and six months ended June 30, 2018, respectively, as compared to 397,171 and 520,097 stock options for the same periods in the prior year. We granted an aggregate of 164,522 and 212,170 restricted stock units during the three and six months ended June 30, 2018, respectively, as compared to an aggregate of 218,350 and 327,200 restricted stock units for the same periods in the prior year. There were 13,546 restricted stock units exercised during the three and six months ended June 30, 2018. There were no restricted stock units exercised during the three and six months ended June 30, 2017.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

Note 12. Earnings Per Share

Basic and Diluted Earnings Per Share

The components of basic and diluted earnings per share, or EPS, are as follows (in thousands, except share and per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$ 10,733	$ 9,865	$ 21,248	$ 13,828
Less: income allocated to participating securities	(1)	(5)	(4)	(8)
Net income attributable to common stockholders (A)	$ 10,732	$ 9,860	$ 21,244	$ 13,820
Weighted average common shares outstanding — basic (B)	47,439,311	46,442,327	47,333,435	46,334,499
Dilutive effect of stock options, RSUs and RSAs	2,057,777	2,558,226	2,073,009	2,572,313
Weighted average common shares outstanding — diluted (C)	49,497,088	49,000,553	49,406,444	48,906,812
Net income per share:				
Basic (A/B)	$ 0.23	$ 0.21	$ 0.45	$ 0.30
Diluted (A/C)	$ 0.22	$ 0.20	$ 0.43	$ 0.28

The following securities have been excluded from the calculation of diluted weighted average common shares outstanding as the inclusion of these securities would have an anti-dilutive effect:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Stock options	191,050	313,650	316,217	313,650
RSAs	23	1,082	23	1,082
RSUs	12,772	—	29,772	148,100
Common stock subject to repurchase	7,052	21,317	7,052	21,317

Participating securities are composed of certain stock options granted under the 2015 Plan, and previously granted under the 2009 Equity Incentive Plan, that may be exercised before the options have vested. Unvested shares have a non-forfeitable right to dividends. Unvested shares issued as a result of early exercise are subject to repurchase by us upon termination of employment or services at the original exercise price. The common stock subject to repurchase is no longer classified as participating securities when shares revert to common stock outstanding as the awards vest and our repurchase right lapses.

Note 13. Significant Service Providers

During the three and six months ended June 30, 2018, our 10 largest revenue service provider partners accounted for 57% and 58% of our revenue, respectively, as compared to 61% for the same periods in the prior year. One of our service provider partners within the Alarm.com segment individually represented greater than 15% but not more than 20% of our revenue for the three and six months ended June 30, 2018. One of our service provider partners within the

Alarm.com segment individually represented greater than 10% but not more than 15% of our revenue for the three months ended June 30, 2017. One of our service provider partners within the Alarm.com segment individually represented greater than 15% but not more than 20% of our revenue for the three months ended June 30, 2017. Two of our service provider partners within the Alarm.com segment individually represented greater than 10% but not more than 15% of our revenue for the six months ended June 30, 2017.

One individual service provider partner in the Alarm.com segment represented more than 10% of accounts receivable as of June 30, 2018 and December 31, 2017.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

Note 14. Income Taxes

For purposes of interim reporting, our annual effective income tax rate is estimated in accordance with ASC 740-270, "Interim Reporting." This rate is applied to the pre-tax book income of the entities expected to be benefited during the year. Discrete items that impact the tax provision are recorded in the period incurred.

The Tax Cuts and Jobs Act, or the Tax Act, was signed into law on December 22, 2017. This legislation made significant changes in U.S. tax law, including a reduction in the corporate tax rate, changes to net operating loss carryforwards and carrybacks and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate income tax rate from 35% to 21%. As a result of the enacted Tax Act, we were required to revalue deferred tax assets and liabilities at the rate in effect when the deferred tax balances are scheduled to reverse. This revaluation resulted in an additional $8.8 million of income tax expense and a corresponding reduction in the deferred tax asset which was recorded during the year ended December 31, 2017.

Additionally, on December 22, 2017, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118, or SAB 118, to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. Specifically, SAB 118 provides a measurement period for companies to evaluate the impacts of the Tax Act on their financial statements. We consider the $8.8 million of income tax expense recorded during the year ended December 31, 2017 to be a provisional amount primarily because we continue to evaluate the tax effects of the Tax Act on taxes related to our international operations, the realizability of deferred tax assets, remeasurement of certain temporary differences at the new tax rates and the impact of other retroactive provisions. During the three and six months ended June 30, 2018, no adjustments were made to the provisional amounts previously recognized.

Our effective income tax rates were (31.2)% and (6.8)% for the three and six months ended June 30, 2018, respectively, as compared to (84.1)% and (40.2)% for the same periods in the prior year. Our effective tax rates were below the statutory rate primarily due to the tax windfall benefits from employee stock-based payment transactions as well as research and development tax credits claimed, partially offset by the impact of non-deductible meal and entertainment expenses.

We recognize a valuation allowance if, based on the weight of available evidence, both positive and negative, it is more likely than not that some portion, or all, of net deferred tax assets will not be realized. Based on our historical and expected future taxable earnings, we believe it is more likely than not that we will realize all of the benefit of the existing deferred tax assets as of June 30, 2018 and December 31, 2017. Accordingly, we have not recorded a valuation allowance as of June 30, 2018 and December 31, 2017.

We apply guidance for uncertainty in income taxes that requires the application of a more likely than not threshold to the recognition and de-recognition of uncertain tax positions. If the recognition threshold is met, this guidance permits us to recognize a tax benefit measured at the largest amount of the tax benefit that, in our judgment, is more likely than not to be realized upon settlement. We recorded an unrecognized tax benefit of less than $0.1 million for research and development tax credits claimed during the six months ended June 30, 2018. For the three and six months ended June 30, 2018, we recorded interest for the period on prior year research and development tax credits we claimed. As of June 30, 2018 and December 31, 2017, we had accrued less than $0.1 million of total interest expense related to unrecognized tax benefits. We recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense.

Note 15. Segment Information

We have two reportable segments:

- Alarm.com segment

- Other segment

Our chief operating decision maker is our chief executive officer. Management determined the operational data used by the chief operating decision maker is that of the two reportable segments. Management bases strategic goals and decisions on these segments and the data presented below is used to measure financial results.

Our Alarm.com segment represents our cloud-based platforms for the intelligently connected property and related solutions that contributed approximately 93% and 94% of our revenue for the three and six months ended June 30, 2018, respectively, as compared to approximately 94% for the same periods in the prior year. Our Other segment is focused on researching, developing and offering residential and commercial automation solutions and energy management products and services in adjacent markets. Inter-segment revenue includes sales of hardware between our segments.

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

Management evaluates the performance of its segments and allocates resources to them based on operating income (loss) as compared to prior periods and current performance levels. The reportable segment operational data is presented in the table below (in thousands):

	Three Months Ended June 30, 2018				
	Alarm.com	Other	Intersegment Alarm.com	Intersegment Other	Total
SaaS and license revenue	$68,076	$2,892	$ —	$ —	$70,968
Hardware and other revenue	30,602	5,508	(1,459)	(1,131)	33,520
Total revenue	98,678	8,400	(1,459)	(1,131)	104,488
Operating income / (loss)	9,427	(930)	(152)	165	8,510

	Three Months Ended June 30, 2017				
	Alarm.com	Other	Intersegment Alarm.com	Intersegment Other	Total
SaaS and license revenue	$57,109	$1,819	$ —	$ —	$58,928
Hardware and other revenue	24,229	3,616	(497)	(288)	27,060
Total revenue	81,338	5,435	(497)	(288)	85,988
Operating income / (loss)	8,819	(2,994)	(39)	110	5,896

	Six Months Ended June 30, 2018				
	Alarm.com	Other	Intersegment Alarm.com	Intersegment Other	Total
SaaS and license revenue	$133,738	$5,218	$ —	$ —	$138,956
Hardware and other revenue	53,603	9,164	(2,241)	(2,238)	58,288
Total revenue	187,341	14,382	(2,241)	(2,238)	197,244
Operating income / (loss)	23,929	(3,467)	(235)	276	20,503

	Six Months Ended June 30, 2017				
	Alarm.com	Other	Intersegment Alarm.com	Intersegment Other	Total
SaaS and license revenue	$105,990	$3,164	$ —	$ —	$109,154
Hardware and other revenue	45,860	6,723	(1,145)	(410)	51,028
Total revenue	151,850	9,887	(1,145)	(410)	160,182
Operating income / (loss)	15,403	(5,207)	(60)	245	10,381

	Alarm.com	Other	Intersegment Alarm.com	Intersegment Other	Total
Assets as of June 30, 2018	$444,614	$18,374	$ (60,189)	$ (3)	$402,796
Assets as of December 31, 2017	405,915	19,144	(53,267)	(151)	371,641

Our SaaS and license revenue for the Alarm.com segment included software license revenue of $10.2 million and $20.1 million for the three and six months ended June 30, 2018, respectively, as compared to $8.5 million and $10.8 million for the same periods in the prior year. There was no software license revenue recorded for the Other segment during the three and six months ended June 30, 2018 and 2017.

Depreciation and amortization expense was $5.2 million and $10.1 million for the Alarm.com segment for the three and six months ended June 30, 2018, respectively, as compared to $4.8 million and $7.6 million for the same periods in the prior year. Depreciation and amortization expense was $0.1 million for the Other segment for each of the three and six months ended June 30, 2018 and 2017. Additions to property and equipment were $3.2 million and $6.2 million for the Alarm.com segment for

ALARM.COM HOLDINGS, INC.
Notes to the Condensed Consolidated Financial Statements (Unaudited) — (Continued)
June 30, 2018 and 2017

the three and six months ended June 30, 2018, respectively, as compared to $3.2 million and $5.0 million for the same periods in the prior year. Additions to property and equipment were less than $0.1 million for the Other segment for each of the three and six months ended June 30, 2018, respectively, as compared to less than $0.1 million for each of the three and six months ended June 30, 2017.

We derived substantially all revenue from North America for the three and six months ended June 30, 2018 and 2017. Substantially all our long-lived assets were in North America as of June 30, 2018 and December 31, 2017.

Note 16. Related Party Transactions

Installation Partner

Our installation partner in which we have a 48.2% ownership interest performs installation services for security dealers and also provides installation services for us and certain of our subsidiaries. We account for this investment using the equity method. As of June 30, 2018 and December 31, 2017, our investment balance in our installation partner was zero. During the three and six months ended June 30, 2018, we recorded $0.1 million and $0.2 million of cost of hardware and other revenue in connection with this installation partner, respectively, as compared to $0.2 million and $0.5 million for the same periods in the prior year. As of June 30, 2018 and December 31, 2017, the accounts payable balance to our installation partner was less than $0.1 million. In September 2014, we loaned $0.3 million to our installation partner under a secured promissory note that accrues interest at 8.0%. Interest is payable monthly with the entire principal balance plus accrued but unpaid interest due at maturity in September 2018. We recorded less than $0.1 million of interest income related to this note receivable in the three and six months ended June 30, 2018 and 2017.

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

You should read the following discussion and analysis of our financial condition and results of operations together with (1) our condensed consolidated financial statements and the related notes and other financial information included elsewhere in this Quarterly Report on Form 10-Q and (2) the audited consolidated financial statements and the related notes and management's discussion and analysis of financial condition and results of operations for the fiscal year ended December 31, 2017 included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed on February 28, 2018 with the Securities and Exchange Commission, or the SEC. This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "plan," "project," "will," "would" or the negative or plural of these similar expressions or variations and such forward-looking statements include, but are not limited to, statements with respect to our outlook; the impact of new accounting standards; our business strategy, plans and objectives for future operations; continued enhancements of our platform and new product offerings and our future financial and business performance. The events described in these forward-looking statements are subject to a number of risks, uncertainties, assumptions and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in this Quarterly Report on Form 10-Q and those discussed in the section titled "Risk Factors" set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our other Securities and Exchange Commission, or SEC, filings. You should not rely upon forward-looking statements as predictions of future events. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

Alarm.com is the leading platform for the intelligently connected property. We offer a comprehensive suite of cloud-based solutions for smart residential and commercial properties, including interactive security, video monitoring, intelligent automation, energy management and wellness solutions. Millions of property owners rely on our technology to intelligently secure, monitor and manage their residential and commercial properties. In the last year alone, our platforms processed more than 100 billion data points generated by over 80 million connected devices. We believe that this scale of subscribers, connected devices and data operations makes us the leader in the connected property market.

Our solutions are delivered through an established network of over 7,000 trusted service providers, who are experts at selling, installing and supporting our solutions. We primarily generate Software-as-a-Service, or SaaS, and license revenue through our service provider partners, who resell these services and pay us monthly fees. Our service provider partners have indicated that they typically have three to five-year service contracts with residential and commercial property owners who use our solutions. We also generate hardware and other revenue, primarily from our service provider partners and distributors. Our hardware sales include gateway modules and other connected devices that enable our services, such as video cameras and smart thermostats. We believe that the length of service contracts with residential and commercial property owners, combined with our robust platforms and over 15 years of operating experience, contribute to a compelling business model.

Our technology platforms are designed to make connected properties safer, smarter and more efficient. Our solutions are used in both smart residential and commercial properties, which we refer to as the connected property market and we have designed our technology platforms for all market participants. This includes not only the residential and commercial property owners who subscribe to our services, but also the hardware partners who manufacture devices that integrate with our platforms and the service provider partners who install and maintain our solutions.

Our service provider partners can deploy our interactive security, video monitoring, intelligent automation and energy management solutions as stand-alone offerings or as combined solutions to address the needs of a broad range of customers. Our technology enables subscribers to seamlessly connect to their property through our family of mobile apps, websites, and new engagement platforms like voice control through Amazon Echo, wearable devices like the Apple Watch, and TV platforms such as Apple TV and Amazon Fire TV.

Highlights of Second Quarter Results

We primarily generate SaaS and license revenue, our largest source of revenue, through our service provider partners who resell our services and pay us monthly fees. Our service provider partners sell, install and support Alarm.com solutions that enable residential and commercial property owners to intelligently secure, connect, control and automate their properties. Our service provider partners have indicated that they typically have three to five-year service contracts with residential or commercial property owners. Our subscribers consist of all of the properties maintained by those residential and commercial property owners to which we are delivering at least one of our solutions. We derive a portion of our revenue from licensing our intellectual property to third parties on a per customer basis. SaaS and license revenue represented 68% and 70% of our revenue during the three and six months ended June 30, 2018, respectively, as compared to 69% and 68% in the same periods in the prior year.

We also generate software license revenue from monthly fees charged to service providers on a per subscriber basis for access to our Connect platform. The Connect software for interactive security, automation and related solutions is typically deployed and operated by the service provider in its own network operations center. Our software license revenue is included within our SaaS and license revenue. Software license revenue represented 10% of our revenue during each of the three and six months ended June 30, 2018, as compared to 10% and 7%, respectively, in the same periods in the prior year.

We also generate revenue from the sale of hardware, including cellular radio modules, video cameras, image sensors, thermostats and other peripherals, that enables our solutions. We have a rich history of innovation in cellular technology that enables our robust SaaS offering. Hardware and other revenue represented 32% and 30% of our revenue during the three and six months ended June 30, 2018, respectively, as compared to 31% and 32%, respectively, in the same periods in the prior year.

We believe there is significant opportunity to expand our international business, as 2% percent of our total revenue during the six months ended June 30, 2018 originated from customers located outside of North America. Our products are currently localized and available in 37 countries outside of North America.

Highlights of our financial performance for the periods covered in this Quarterly Report include:

- SaaS and license revenue increased 20% to $71.0 million in the three months ended June 30, 2018 from $58.9 million in the three months ended June 30, 2017. SaaS and license revenue increased 27% to $139.0 million in the six months ended June 30, 2018 from $109.2 million in the six months ended June 30, 2017. Included in SaaS and license revenue was software license revenue, which increased to $10.2 million in the three months ended June 30, 2018 from $8.5 million in the three months ended June 30, 2017. Software license revenue increased to $20.1 million in the six months ended June 30, 2018 from $10.8 million in the six months ended June 30, 2017.

- Revenue increased 22% to $104.5 million in the three months ended June 30, 2018 from $86.0 million in the three months ended June 30, 2017. Revenue increased 23% to $197.2 million in the six months ended June 30, 2018 from $160.2 million in the six months ended June 30, 2017.

- Net income was $10.7 million and $9.9 million for the three months ended June 30, 2018 and 2017, respectively. Net income was $21.2 million and $13.8 million for the six months ended June 30, 2018 and 2017, respectively.

- Adjusted EBITDA, a non-GAAP measurement of operating performance, increased to $23.4 million in the three months ended June 30, 2018 from $15.9 million in the three months ended June 30, 2017. Adjusted EBITDA increased to $46.4 million in the six months ended June 30, 2018 from $30.0 million in the six months ended June 30, 2017.

Please see Non-GAAP Measures below in this section of this Quarterly Report for a discussion of the limitations of Adjusted EBITDA (a non-GAAP measure) and a reconciliation of Adjusted EBITDA to net income, the most comparable measurement in accordance with accounting principles generally accepted in the United States, or GAAP, for the three and six months ended June 30, 2018 and 2017.

Other Business Metrics

We regularly monitor a number of financial and operating metrics in order to measure our current performance and estimate our future performance. Our other business metrics may be calculated in a manner different than similar other business metrics used by other companies and include the following (dollars in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
SaaS and license revenue	$70,968	$58,928	$138,956	$109,154
Adjusted EBITDA	23,409	15,881	46,367	29,984

	Twelve Months Ended June 30,	
	2018	2017
SaaS and license revenue renewal rate	94 %	93 %

SaaS and License Revenue

We believe that SaaS and license revenue is an indicator of the productivity of our existing service provider partners and their ability to activate and maintain subscribers using our intelligently connected property solutions, our ability to add new service provider partners reselling our solutions, the demand for our intelligently connected property solutions and the pace at which the market for these solutions is growing.

Adjusted EBITDA

Adjusted EBITDA represents our net income before interest expense, other income, net, amortization and depreciation expense, stock-based compensation expense, acquisition-related expense and legal costs and settlement fees incurred in connection with non-ordinary course litigation and other disputes, particularly costs involved in ongoing intellectual property litigation. We do not consider these items to be indicative of our core operating performance. The non-cash items include amortization and depreciation expense and stock-based compensation expense. We do not adjust for ordinary course legal expenses resulting from maintaining and enforcing our intellectual property portfolio and license agreements.

Adjusted EBITDA is a key measure that our management uses to understand and evaluate our core operating performance and trends to generate future operating plans, to make strategic decisions regarding the allocation of capital, and to make investments in initiatives that are focused on cultivating new markets for our solutions. In particular, the exclusion of certain expenses in calculating Adjusted EBITDA facilitates comparisons of our operating performance on a period-to-period basis and, in the case of exclusion of acquisition-related adjustments and certain historical legal expenses, excludes items that we do not consider to be indicative of our core operating performance. Adjusted EBITDA is not a measure calculated in accordance with GAAP and should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. Please see Non-GAAP Measures in this section for a discussion of the limitations of Adjusted EBITDA and a reconciliation of Adjusted EBITDA to net income, the most comparable GAAP measurement, for the three and six months ended June 30, 2018 and 2017.

SaaS and License Revenue Renewal Rate

We measure our SaaS and license revenue renewal rate on a trailing 12-month basis by dividing (a) the total SaaS and license revenue recognized during the trailing 12-month period from our subscribers on our Alarm.com platform who were subscribers on the first day of the period, by (b) total SaaS and license revenue we would have recognized during the period from those same subscribers assuming no terminations, or service level upgrades or downgrades. The SaaS and license revenue renewal rate represents both residential and commercial properties. Our SaaS and license revenue renewal rate is expressed as an annualized percentage. Our service provider partners, who resell our services to our subscribers, have indicated that they typically have three to five-year service contracts with our subscribers. Our SaaS and license revenue renewal rate is calculated across our entire subscriber base on the Alarm.com platform, including subscribers whose contract with their service provider reached the end of its contractual term during the measurement period, as well as subscribers whose contract with their service provider has not reached the end of its contractual term during the measurement period, and is not intended to estimate the rate at which our subscribers renew their contracts with our service provider partners. We believe that our SaaS and license revenue renewal rate allows us to measure our ability to retain and grow our SaaS and license revenue and serves as an indicator of the lifetime value of our subscriber base.

Revenue from Contracts with Customers (Topic 606)

In May 2014, the Financing Accounting Standards Board, or FASB, and International Accounting Standards Board jointly issued Accounting Standards Update, or ASU, 2014-09, "Revenue from Contracts with Customers (Topic 606)," a new revenue recognition standard that provides a framework for addressing revenue issues, improves the comparability of revenue recognition practices across industries, provides useful information to users of financial statements through improved disclosure requirements and simplifies the presentation of financial statements. On January 1, 2018, we adopted Topic 606 by applying the modified retrospective transition method to all of our contracts. Comparative information has not been restated and continues to be reported under the accounting standards in effect for the periods presented.

The adoption of Topic 606 did not have a material impact on our revenue recognition policies, however, as a result of adopting the new standard, we changed our treatment of commissions paid to employees, which we previously expensed as incurred. Under the new standard, we capitalize a portion of our commission costs as an incremental cost of obtaining a contract and amortize our commission costs over a period of three years, which is consistent with the period over which the products and services related to the commission are transferred to the customer. Based on the results of our evaluation, the adoption of Topic 606 did not have a material impact on our condensed consolidated financial statements for the three and six months ended June 30, 2018. Additionally, the cumulative effect to the opening balance sheet on January 1, 2018 from the adoption of Topic 606 was not material.

Components of Operating Results

Our fiscal year ends on December 31. The key elements of our operating results include:

Revenue

We derive our revenue from three primary sources: the sale of cloud-based SaaS services on our integrated Alarm.com platform, the sale of licenses and services on the Connect software platform and the sale of hardware products. We sell our platform and hardware solutions to service provider partners that resell our solutions and hardware to residential and commercial property owners, who are the service provider partners' customers.

SaaS and License Revenue. We generate the majority of our SaaS and license revenue primarily from monthly fees charged to our service provider partners sold on a per subscriber basis for access to our cloud-based intelligently connected property platform and related solutions. Our fees per subscriber vary based upon the service plan and features utilized.

Under the terms of our contractual arrangements with our service provider partners, we bill a monthly fee to our service provider partners in advance of the month of service, with the exception of the initial partial month of service, which is paid in arrears. Due to the limited period of time between receipt of payment and delivery of service, we have not accounted for these advance payments as significant financing components. We typically transfer the promised SaaS services to our customers over time, which is evidenced by the fact that the customers receive and consume the benefits provided by our performance of the services as such services are rendered. As a result, we recognize revenue from SaaS services on a monthly basis as we satisfy our performance obligations. We have demonstrated that we can sell our SaaS offering on a stand-alone basis, as it can be sold separately from hardware and activation services. As there is neither a minimum required initial service term nor a stated renewal term in our contractual arrangements, we recognize revenue over the period of service, which is monthly. Our service provider partners typically incur and pay the same monthly fee per subscriber account for the entire period a subscriber account is active.

We offer multiple service level packages for our platform solutions including a range of solutions and a range of a la carte add-ons for additional features. The fee paid by our service provider partners each month for the delivery of our solutions is based on the combination of packages and add-ons enabled for each subscriber. We utilize tiered pricing plans where our service provider partners may receive prospective pricing discounts driven by volume.

We also generate SaaS and license revenue from the fees paid to us when we license our intellectual property to third parties for use of our patents. We bill a monthly fee to third parties based on the number of customers that were active during the prior month. We apply the usage-based royalty exception to recognize license revenue because the sole or predominant item to which the royalty relates is the license of intellectual property. Under the usage-based royalty exception, we recognize revenue on a monthly basis over the period of service. In addition, in certain markets our EnergyHub subsidiary sells its demand response service for an annual service fee, with pricing based on the number of subscribers or amount of aggregate electricity demand made available for a utility's or market's control.

Software License Revenue. Our SaaS and license revenue also includes our software license revenue from monthly fees charged to service providers sold on a per subscriber basis for access to our Connect software platform. The Connect software for interactive security, automation and related solutions is typically deployed and operated by the service provider in its own network operations center. Our agreements for the Connect platform solution typically include software and services, such as post-contract customer support, or PCS. Software sales that include multiple elements are typically allocated to the various elements using the relative stand-alone selling price method. We apply the usage-based royalty exception to recognize license revenue associated with software hosted by our customers because the predominant item to which the royalty relates is the license of intellectual property. Under the usage-based royalty exception, we recognize revenue on a monthly basis over the period during which the services are expected to be performed. Under the terms of our contractual arrangements with our service provider partners, we are entitled to payment of a monthly fee that is billed per subscriber for the month of service.

Hardware and Other Revenue. We generate hardware and other revenue primarily from the sale of video cameras and cellular radio modules that provide access to our cloud-based platforms and, to a lesser extent, the sale of other devices, including image sensors and peripherals. We primarily transfer hardware to our customers upon delivery to the customer, which corresponds with the time at which the customer obtains legal title to the hardware. As a result, we recognize hardware and other revenue as we satisfy our performance obligations, which occurs when the hardware is received by our service provider partner or distributor, net of a reserve for estimated returns. There are a few contracts in which we provide shipping and handling services to the customer after control of the hardware transfers to the customer. In these instances, we have elected to account for shipping and handling costs as activities performed to fulfill the promise to transfer hardware to the customer and not as a separate promised service.

Amounts due from the sale of hardware are payable in accordance with the terms of our agreements with our service provider partners or distributors, and are not contingent on resale to end-users, or to service provider partners in the case of sales of hardware to distributors. Payment for our hardware is typically due within 30 days from shipment, with the exception of certain hardware finance arrangements, which are paid over a 36-month period. Our terms for hardware sales sold directly to either service provider partners or distributors typically allow for the return of hardware up to one year past the date of sale. Our distributors sell directly to our service provider partners under terms between the two parties.

When determining the amount of consideration we expect to be entitled to for the sale of our hardware, we estimate the variable consideration associated with customer returns. We record a reserve against revenue for hardware returns based on historical returns, which was 2% of hardware and other revenue for each of the twelve months ended June 30, 2018 and 2017. We evaluate our hardware reserve on a quarterly basis or if there is an indication of significant changes in return experience. Historically, our returns of hardware have not significantly differed from our estimated reserve. In general, we provide assurance-type warranties related to the intended functionality of the products and services provided. These warranties were not identified as separate performance obligations.

Hardware and other revenue also includes activation fees charged to service provider partners for activation of a new subscriber account on our platforms, as well as fees paid by service provider partners for our marketing services. Our service provider partners use services on our platforms, such as support tools and applications, to assist in the installation of our solutions in subscriber properties. This installation marks the beginning of the service period on our platforms and, on occasion, we earn activation revenue for fees charged for this service. The activation fee is non-refundable, separately negotiated and specified in our contractual arrangements with our service provider partners and is charged to the service provider partner for each subscriber activated on our platforms. The decision whether to charge an activation fee is based in part on the expected number of subscribers to be added by our service provider partners and as a result, many of our largest service provider partners do not pay an activation fee. Activation fees are not offered on a stand-alone basis separate from our SaaS offering and are billed and received at the beginning of the arrangement. We record activation fees initially as deferred revenue and we recognize these fees ratably over the expected term of the subscribers' account which we estimate is ten years based on our annual attrition rate. The portion of these activation fees included in current and long-term deferred revenue as of our balance sheet date represents the amounts that will be recognized ratably as revenue over the following twelve months, or longer as appropriate, until the ten-year expected term is complete. The balance of deferred revenue for activation fees was $9.9 million and $10.5 million as of June 30, 2018 and December 31, 2017, respectively, which combines current and long-term balances.

Cost of Revenue

Our cost of SaaS and license revenue primarily includes the amounts paid to wireless network providers and, to a lesser extent, the costs of running our network operation centers which are expensed as incurred, as well as royalty costs in connection with technology licensed from third-party providers. Our cost of SaaS and license revenue also includes our cost of software license revenue, which primarily includes the payroll and payroll-related costs of the department dedicated to providing service exclusively to those service providers that host the Connect platform. Our cost of hardware and other revenue primarily includes cost of raw materials and amounts paid to our third-party manufacturer for production and fulfillment of our cellular radio modules and image sensors, and procurement costs for our video cameras, which we purchase from an original equipment manufacturer, and other devices. Our cost of hardware and other revenue also includes royalty costs in connection with technology licensed from third-party providers.

We record the cost of SaaS and license revenue as expenses are incurred, which corresponds to the delivery period of our services to our subscribers. We record the cost of hardware and other revenue when the hardware and other services are delivered to the service provider partner, which occurs when legal title transfers to the service provider partner. Our cost of revenue excludes amortization and depreciation.

Operating Expenses

Our operating expenses consist of sales and marketing, general and administrative, research and development and amortization and depreciation expenses. Salaries, bonuses, stock-based compensation, benefits and other personnel related costs are the most significant components of each of these expense categories, excluding amortization and depreciation. We include stock-based compensation expense in connection with the grant of stock options and other forms of equity compensation in the applicable operating expense category based on the respective equity award recipient's function (sales and marketing, general and administrative or research and development). We grew from 750 employees as of June 30, 2017 to 828 employees as of June 30, 2018, and we expect to continue to hire new employees to support the projected future growth of our business.

Sales and Marketing Expense. Sales and marketing expense consists primarily of personnel and related expenses for our sales and marketing teams, including salaries, bonuses, stock-based compensation, benefits, travel, and commissions. Our sales and marketing teams engage in sales, account management, service provider partner support, advertising, promotion of our products and services and marketing.

The number of employees in sales and marketing functions increased from 239 as of June 30, 2017 to 269 as of June 30, 2018. We expect to continue to invest in our sales and marketing activities to expand our business both domestically and internationally and, as a result, expect our sales and marketing expense to increase on an absolute dollar basis and increase as a percentage of our total revenue to levels consistent with 2016 in the short term. We intend to increase the size of our sales force and our service provider partner support team to provide additional support to our existing service provider partner base to drive their productivity in selling our solutions as well as to enroll new service provider partners in North America and in international markets. We also intend to increase our marketing investments in the form of marketing programs, trade shows and training to support our service provider partners' efforts to enroll new subscribers and expand the adoption of our solutions.

General and Administrative Expense. General and administrative expense consists primarily of personnel and related expenses for our administrative, legal, information technology, human resources, finance and accounting personnel, including salaries, bonuses, stock-based compensation, benefits and other personnel costs. Additional expenses included in this category are legal costs, including those that are incurred to defend and license our intellectual property, as well as non-personnel costs, such as travel related expenses, rent, subcontracting and professional fees, audit fees, tax services, and insurance expenses. Also included in general and administrative expenses are acquisition-related expenses, which consist primarily of legal, accounting and professional service fees directly related to acquisitions, valuation gains or losses on acquisition-related contingent liabilities.

The number of employees in general and administrative functions increased from 82 as of June 30, 2017 to 93 as of June 30, 2018. Excluding intellectual property litigation and acquisition-related costs, we expect general and administrative costs to increase prospectively as our business grows. This includes cost increases related to accounting, finance, and legal personnel, additional external legal, audit fees and other expenses associated with regulations governing public companies. We will continue to incur additional costs associated with being a public company including higher legal, corporate insurance and accounting expenses, including the additional costs of maintaining compliance with Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, which has resulted in additional external audit and consulting fees. While somewhat unpredictable, we also expect to continue to incur costs related to litigation involving intellectual property, as well as integration costs associated with the acquisition of the Connect and Piper business units from Icontrol, which closed on March 8, 2017, which we refer to in this report as the Acquisition.

Research and Development Expense. Research and development expense consists primarily of personnel and related expenses for our employees working on our product development and software and device engineering teams, including salaries, bonuses, stock-based compensation, benefits and other personnel costs. Also included are non-personnel costs such as consulting and professional fees paid to third-party development resources.

The number of employees in research and development functions increased from 429 as of June 30, 2017 to 466 as of June 30, 2018. Our research and development efforts are focused on innovating new features and enhancing the functionality of our platforms and the solutions we offer to our service provider partners and subscribers. We will also continue to invest in efforts to extend our platforms to adjacent markets and internationally. We expect research and development expenses to continue to increase on an absolute dollar basis and as a percentage of revenue in the short term to maintain our leadership position in the development of intelligently connected property technology, and continued enhancement of our Enterprise Tools platform for our service provider partners.

Amortization and Depreciation. Amortization and depreciation consists of amortization of intangible assets originating from our acquisitions as well as our internally-developed capitalized software. Our depreciation expense is related to investments in property and equipment. Acquired intangible assets include developed technology, customer related intangibles, trademarks and trade names. We expect in the near term that amortization and depreciation may fluctuate based on our acquisition activity, development of our platforms and capitalized expenditures.

Interest Expense

Interest expense consists of interest expense associated with our credit facilities. On October 6, 2017, we entered into a $125.0 million senior secured revolving credit facility, or the 2017 Facility, with SVB, as administrative agent, PNC Bank, National Association, as documentation agent, and a syndicate of lenders. The 2017 Facility is available to us to refinance existing debt and for general corporate and working capital purposes as permitted under the terms of the 2017 Credit Facility. Interest expense is expected to increase in 2018 as compared to 2017, as we utilized the 2017 Facility for the Acquisition.

Other Income, Net

Other income, net consists of our portion of the income or loss from our minority investments in other businesses accounted for under the equity method and interest income earned on our cash and cash equivalents and our notes receivable.

Provision for Income Taxes

The Tax Cuts and Jobs Act, or the Tax Act, was signed into law on December 22, 2017. This legislation made significant changes in U.S. tax law, including a reduction in the corporate tax rate, changes to net operating loss carryforwards and carrybacks and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate income tax rate from 35% to 21%.

We are subject to U.S. federal, state and local income taxes as well as foreign income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. As a result, we recognize tax liabilities based on estimates of whether additional taxes will be due. Our effective tax rate was below the statutory rate primarily due to the tax windfall benefits from employee stock-based payment transactions as well as research and development tax credits claimed, partially offset by the impact of non-deductible meal and entertainment expenses. We recognize excess tax windfall benefits on a discrete basis in the quarter in which it occurs, and we anticipate that our effective tax rate will vary from quarter to quarter depending on our stock price and exercises of stock options under our equity incentive plans each period.

Results of Operations

The following table sets forth our unaudited selected condensed consolidated statements of operations and data as a percentage of revenue for the periods presented (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
Revenue:								
SaaS and license revenue	$70,968	68 %	$58,928	69 %	$138,956	70 %	$109,154	68 %
Hardware and other revenue	33,520	32	27,060	31	58,288	30	51,028	32
Total revenue	104,488	100	85,988	100	197,244	100	160,182	100
Cost of revenue(1):								
Cost of SaaS and license revenue	11,027	11	8,500	10	21,833	11	16,592	10
Cost of hardware and other revenue	25,461	24	21,335	25	43,032	22	39,878	25
Total cost of revenue	36,488	35	29,835	35	64,865	33	56,470	35
Operating expenses(2):								
Sales and marketing	14,612	14	11,899	14	25,434	13	22,213	14
General and administrative	18,119	17	13,450	16	34,281	17	28,825	18
Research and development	21,521	21	20,062	22	41,898	21	34,583	22
Amortization and depreciation	5,238	5	4,846	6	10,263	5	7,710	5
Total operating expenses	59,490	57	50,257	58	111,876	56	93,331	58
Operating income	8,510	8	5,896	7	20,503	11	10,381	7
Interest expense	(751)	(1)	(674)	(1)	(1,423)	(1)	(890)	(1)
Other income, net	420	—	137	—	816	—	374	—
Income before income taxes	8,179	7	5,359	6	19,896	10	9,865	6
Benefit from income taxes	(2,554)	(3)	(4,506)	(5)	(1,352)	(1)	(3,963)	(3)
Net income	$10,733	10 %	$9,865	11 %	$21,248	11 %	$13,828	9 %

(1) Exclusive of amortization and depreciation shown in operating expenses below.
(2) Operating expenses include stock-based compensation expense as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Stock-based compensation expense data:				
Sales and marketing	$319	$65	$554	$178
General and administrative	1,481	755	2,509	1,324
Research and development	1,744	1,095	3,150	1,726

Total stock-based compensation expense	$3,544	$1,915	$6,213	$3,228

33

The following table sets forth the components of cost of revenue as a percentage of revenue:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
Components of cost of revenue as a percentage of revenue:								
Cost of SaaS and license revenue as a percentage of SaaS and license revenue	16	%	14	%	16	%	15	%
Cost of hardware and other revenue as a percentage of hardware and other revenue	76	%	79	%	74	%	78	%
Total cost of revenue as a percentage of total revenue	35	%	35	%	33	%	35	%

Comparison of the Three and Six Months Ended June 30, 2018 to June 30, 2017

The following tables in this section set forth our selected condensed consolidated statements of operations (in thousands), data for the percentage change and data as a percentage of revenue for the periods presented:

Revenue

	Three Months Ended June 30,		% Change		Six Months Ended June 30,		% Change	
	2018	2017			2018	2017		
Revenue:								
SaaS and license revenue	$70,968	$58,928	20	%	$138,956	$109,154	27	%
Hardware and other revenue	33,520	27,060	24		58,288	51,028	14	
Total revenue	$104,488	$85,988	22	%	$197,244	$160,182	23	%

The $18.5 million increase in total revenue for the three months ended June 30, 2018 as compared to the same period in the prior year was primarily the result of a $12.0 million, or 20%, increase in our SaaS and license revenue and a $6.5 million, or 24%, increase in our hardware and other revenue. Our software license revenue included within SaaS and license revenue increased $1.7 million to $10.2 million during the three months ended June 30, 2018 as compared to $8.5 million during the same period in the prior year. The increase in our Alarm.com segment SaaS and license revenue for the three months ended June 30, 2018 was primarily due to growth in our subscriber base, including the revenue impact from subscribers we added in 2017. To a lesser extent, SaaS and license revenue increased in the period due to an increase in license fees. The increase in hardware and other revenue for the three months ended June 30, 2018 as compared to the same period in the prior year was due to an increase in the volume of video cameras sold and due to increases in volume of other peripherals sold including the system enhancement module. Our Other segment contributed 9% of the increase in SaaS and license revenue for the three months ended

June 30, 2018 as compared to the same period in the prior year. The increase in SaaS and license revenue for our Other segment for the three months ended June 30, 2018 was from our remote access management solution and our energy management and demand response solutions. The hardware and other revenue for our Other segment increased by $1.0 million for the three months ended June 30, 2018 as compared to the same period in the prior year, primarily due to the timing of sales related to our remote access management solution.

The $37.1 million increase in total revenue for the six months ended June 30, 2018 as compared to the same period in the prior year was primarily the result of a $29.8 million, or 27%, increase in our SaaS and license revenue and a $7.3 million, or 14%, increase in our hardware and other revenue. Our software license revenue included within SaaS and license revenue increased $9.3 million to $20.1 million during the six months ended June 30, 2018 as compared to $10.8 million during the same period in the prior year. The increase in our Alarm.com segment SaaS and license revenue for the six months ended June 30, 2018 was primarily due to growth in our subscriber base, including the revenue impact from subscribers we added in 2017. Additionally, the increase in the software license revenue was due to the timing of the Acquisition. To a lesser extent, SaaS and license revenue increased in the period due to an increase in license fees. The increase in hardware and other revenue for the six months ended June 30, 2018 as compared to the same period in the prior year was primarily due to an increase in the volume of video cameras sold. Our Other segment contributed 7% of the increase in SaaS and license revenue for the six months ended June 30, 2018 as compared to the same period in the prior year. The increase in SaaS and license revenue for our Other segment for the six months ended June 30, 2018 was from our remote access management solution and our energy management and demand response solutions. The hardware and other revenue for our Other segment increased by $0.6 million for the six months ended June 30, 2018 as compared to the same period in the prior year, primarily due to the timing of sales related to our remote access management solution.

Cost of Revenue

	Three Months Ended June 30, 2018	2017	% Change	Six Months Ended June 30, 2018	2017	% Change
Cost of revenue(1):						
Cost of SaaS and license revenue	$11,027	$8,500	30 %	$21,833	$16,592	32 %
Cost of hardware and other revenue	25,461	21,335	19	43,032	39,878	8
Total cost of revenue	$36,488	$29,835	22 %	$64,865	$56,470	15 %
% of total revenue	35 %	35 %		33 %	35 %	

(1) Excludes amortization and depreciation.

The $6.7 million increase in cost of revenue for the three months ended June 30, 2018 as compared to the same period in the prior year was the result of a $2.5 million, or 30%, increase in cost of SaaS and license revenue and a $4.1 million, or 19%, increase in cost of hardware and other revenue. Our cost of software license revenue included within cost of SaaS and license revenue increased $0.1 million to $0.4 million during the three months ended June 30, 2018 as compared to $0.3 million during the same period in the prior year. The increase in cost of Alarm.com segment SaaS and license revenue related primarily to the growth in our subscriber base, which drove a corresponding increase in amounts paid to wireless network providers and, to a lesser extent, the costs of running our network operating centers. Cost of SaaS and license revenue as a percentage of SaaS and license revenue was 16% for the three months ended June 30, 2018 and 14% for the same period in the prior year. Cost of software license revenue as a percentage of software license revenue was 4% for each of the three months ended June 30, 2018 and 2017. Cost of hardware and other revenue as a percentage of hardware and other revenue was 76% for the three months ended June 30, 2018 and 79% for the same period in the prior year. The decrease in cost of hardware and other revenue as a percentage of hardware and other revenue for the three months ended June 30, 2018 as compared to the same period in the prior year is a reflection of the mix of product sales during the periods.

The $8.4 million increase in cost of revenue for the six months ended June 30, 2018 as compared to the same period in the prior year was the result of a $5.2 million, or 32%, increase in cost of SaaS and license revenue and a $3.2 million, or 8%, increase in cost of hardware and other revenue. Our cost of software license revenue included within cost of SaaS and license revenue increased $0.5 million to $0.9 million during the six months ended June 30, 2018 as compared to $0.4 million during the same period in the prior year. The increase in cost of Alarm.com segment SaaS and license revenue related primarily to the growth in our subscriber base, which drove a corresponding increase in amounts paid to wireless network providers and, to a lesser extent, the costs of running our network operating centers. Additionally, the increase in the cost of software license revenue was due to the timing of the Acquisition. Cost of SaaS and license revenue as a percentage of SaaS and license revenue was 16% for the six months ended June 30, 2018 and 15% for the same period in the prior year. Cost of software license revenue as a percentage of software license revenue was 4% for each of the six months ended June 30, 2018 and 2017. Cost of hardware and other revenue as a percentage of hardware and other revenue was 74% for the six months ended June 30, 2018 and 78% for the same period in the prior year. The decrease in cost of hardware and other revenue as a percentage of hardware and other revenue for the six months ended June 30, 2018 as compared to the same period in the prior year is a reflection of the mix of product sales during the periods.

Sales and Marketing Expense

	Three Months Ended June 30, 2018	2017	% Change	Six Months Ended June 30, 2018	2017	% Change

Sales and marketing	$14,612	$11,899	23 %	$25,434	$22,213	15 %
% of total revenue	14 %	14 %		13 %	14 %	

The $2.7 million increase in sales and marketing expense for the three months ended June 30, 2018 as compared to the same period in the prior year was primarily due to increases in our marketing programs to support our service provider partners' efforts to enroll new subscribers and expand the adoption of our solutions. Additionally, the increase in sales and marketing expense was due to increases in headcount for our service provider partner support team to support our growth. As a result, our marketing expense for our Alarm.com segment increased $2.1 million for the three months ended June 30, 2018 as compared to the same period in the prior year. Our personnel and related costs for our Alarm.com segment, including salary, benefits, stock-based compensation and travel expenses, increased by $0.4 million for the three months ended June 30, 2018 and our expenses for external consultants increased by $0.2 million. Sales and marketing expense from our Other segment remained relatively consistent for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. Sales and marketing expense as a percentage of total revenue was 14% for each of the three months ended June 30, 2018 and 2017.

The $3.2 million increase in sales and marketing expense for the six months ended June 30, 2018 as compared to the same period in the prior year was primarily due to increases in our marketing programs to support our service provider partners' efforts to enroll new subscribers and expand the adoption of our solutions. Additionally, the increase in sales and marketing was due to increases in headcount for our service provider partner support team to support our growth. As a result, our marketing expense for our Alarm.com segment increased $1.7 million for the six months ended June 30, 2018 as compared to the same period in the prior year. Our personnel and related costs for our Alarm.com segment, including salary, benefits, stock-based compensation and travel expenses, increased by $0.9 million for the six months ended June 30, 2018 and our expenses for external consultants increased by $0.3 million. Sales and marketing expense from our Other segment remained relatively consistent for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. The number of employees in sales and marketing functions grew from 239 as of June 30, 2017 to 269 as of June 30, 2018. Sales and marketing expense as a percentage of total revenue was 13% and 14% for the six months ended June 30, 2018 and 2017, respectively.

General and Administrative Expense

	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2018	2017		2018	2017	
General and administrative	$18,119	$13,450	35 %	$34,281	$28,825	19 %
% of total revenue	17 %	16 %		17 %	18 %	

The $4.7 million increase in general and administrative expense for the three months ended June 30, 2018 as compared to the same period in the prior year was primarily due to a $5.6 million increase in legal expenses related to ongoing intellectual property litigation within our Alarm.com segment. This increase was partially offset by a $1.2 million decrease in acquisition-related expenses related to the Acquisition. General and administrative expenses from our Other segment remained relatively consistent for the three months ended June 30, 2018 as compared to the same period in the prior year.

The $5.5 million increase in general and administrative expense for the six months ended June 30, 2018 as compared to the same period in the prior year was primarily due to a $7.4 million increase in legal expenses related to ongoing intellectual property litigation within our Alarm.com segment. Additionally, there was a $0.9 million increase in personnel and related costs for our Alarm.com segment due to an increase in employee headcount to support our operational growth and from the addition of the Connect and ObjectVideo Labs teams. The increase was also due to a $0.5 million increase in expense for external consultants within our Alarm.com segment to support our growth and compliance with the regulations governing public companies as well as a $0.4 million increase in rent expense. These increases were partially offset by a $4.8 million decrease in acquisition-related expenses related to the Acquisition. General and administrative expenses from our Other segment increased by $0.8 million for the six months ended June 30, 2018 as compared to the same period in the prior year, primarily due to a $0.8 million increase in expense for external consultants. The number of employees in general and administrative functions increased from 82 as of June 30, 2017 to 93 as of June 30, 2018.

Research and Development Expense

	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2018	2017		2018	2017	
Research and development	$21,521	$20,062	7 %	$41,898	$34,583	21 %
% of total revenue	21 %	22 %		21 %	22 %	

The $1.5 million increase in research and development expense for the three months ended June 30, 2018 as compared to the same period in the prior year was primarily due to an increase in headcount of employees in research and development functions. Our personnel and related costs for our Alarm.com segment increased by $2.0 million for the three months ended June 30, 2018 as compared to the same period in the prior year. Research and development expense from our Other segment decreased by $0.6 million for the three months ended June 30, 2018 as compared to the same period in the prior year, primarily due to a decrease in the development efforts within our Piper business and a corresponding decrease in related expense.

The $7.3 million increase in research and development expense for the six months ended June 30, 2018 as compared to the same period in the prior year was primarily due to an increase in headcount of employees in research and development functions as a result of the Acquisition and the ObjectVideo Labs acquisition. Our personnel and related costs for our Alarm.com segment increased by $5.8 million in for the six months ended June 30, 2018 as compared to the same period in the prior year. In addition, expense for external consultants and information technology to support our research and development personnel increased by $1.8 million for the six months ended June 30, 2018. Research and development expense from our Other segment decreased by $0.2 million for the six months ended June 30, 2018 as compared to the same period in the prior year, primarily due to a $0.5 million decrease in development expense related to the decrease in the development efforts within our Piper business. This decrease was partially offset by a $0.3 million increase in personnel and related expense. The number of employees in research and development functions increased from 429 as of June 30, 2017 to 466 as of June 30, 2018.

Amortization and Depreciation

	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2018	2017		2018	2017	
Amortization and depreciation	$5,238	$4,846	8 %	$10,263	$7,710	33 %
% of total revenue	5 %	6 %		5 %	5 %	

Amortization and depreciation increased $0.4 million and $2.6 million for the three and six months ended June 30, 2018, respectively, as compared to the same periods in the prior year, primarily due to customer relationships, developed technology and trade name intangibles acquired in connection with the Acquisition.

Interest Expense

	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2018	2017		2018	2017	
Interest expense	$(751)	$(674)	11 %	$(1,423)	$(890)	60 %
% of total revenue	(1)%	(1)%		(1)%	(1)%	

Interest expense increased $0.1 million and $0.5 million for the three and six months ended June 30, 2018, respectively, as compared to the same periods in the prior year. The increase in interest expense for the six months ended June 30, 2018 as compared to the same periods in the prior year is primarily due to a higher average outstanding balance on our credit facility as a result of the Acquisition.

Other Income, Net

	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2018	2017		2018	2017	
Other income, net	$420	$137	207 %	$816	$374	118 %
% of total revenue	— %	— %		— %	— %	

Other income, net increased $0.3 million and $0.4 million for the three and six months ended June 30, 2018, respectively, as compared to the same periods in the prior year. Included in other income, net was interest income earned on our cash balance and interest income earned on notes receivable.

Benefit from Income Taxes

	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2018	2017		2018	2017	
Benefit from income taxes	$(2,554)	$(4,506)	(43)%	$(1,352)	$(3,963)	(66)%

% of total revenue	(3)%	(5)%	(1)%	(3)%

Our effective income tax rates were (31.2)% and (6.8)% for the three and six months ended June 30, 2018, respectively, as compared to (84.1)% and (40.2)% for the same periods in the prior year. The increase in the effective tax rates was primarily related to a decrease in the tax windfall benefits from the exercise of employee stock options as well as a decrease in the research and development tax credits claimed for the three and six months ended June 30, 2018 as compared to the same periods in the prior year.

Segment Information

We have two reportable segments: Alarm.com and Other. Our Alarm.com segment represents our cloud-based platforms for the intelligently connected property and related solutions that contributed 93% and 94% of our revenue for the three and six months ended June 30, 2018, respectively, as compared to 94% for the same periods in the prior year. Our Other segment is focused on researching, developing and offering residential and commercial automation solutions and energy management products and services in adjacent markets. The consolidated subsidiaries that make up our Other segment are in the investment stage and have incurred significant operating expenses relative to their revenue.

Our Alarm.com segment increased from 672 employees as of June 30, 2017 to 752 employees as of June 30, 2018. Our Other segment decreased from 78 employees as of June 30, 2017 to 76 employees as of June 30, 2018. Inter-segment revenue includes sales of hardware between our segments.

The following table presents our revenue, inter-segment revenue and operating expenses by segment (in thousands):

	Three Months Ended June 30,					
	2018			2017		
	SaaS and license revenue	Hardware and other revenue	Operating expenses	SaaS and license revenue	Hardware and other revenue	Operating expenses
Alarm.com	$68,076	$30,602	$55,096	$57,109	$24,229	$45,097
Other	2,892	5,508	4,394	1,819	3,616	5,160
Intersegment Alarm.com	—	(1,459)	—	—	(497)	—
Intersegment Other	—	(1,131)	—	—	(288)	—
Total	$70,968	$33,520	$59,490	$58,928	$27,060	$50,257

	Six Months Ended June 30,					
	2018			2017		
	SaaS and license revenue	Hardware and other revenue	Operating expenses	SaaS and license revenue	Hardware and other revenue	Operating expenses
Alarm.com	$133,738	$53,603	$102,327	$105,990	$45,860	$84,337
Other	5,218	9,164	9,549	3,164	6,723	8,994
Intersegment Alarm.com	—	(2,241)	—	—	(1,145)	—
Intersegment Other	—	(2,238)	—	—	(410)	—
Total	$138,956	$58,288	$111,876	$109,154	$51,028	$93,331

Our SaaS and license revenue for the Alarm.com segment included software license revenue of $10.2 million and $20.1 million for the three and six months ended June 30, 2018, respectively, as compared to $8.5 million and $10.8 million for the same periods in the prior year. There was no software license revenue recorded for the Other segment during the three and six months ended June 30, 2018 and 2017.

Critical Accounting Policies and Significant Judgments and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the

reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue, costs and expenses during the reported period. In accordance with GAAP, we base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions, and to the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.
During the first quarter of 2018, we adopted Accounting Standards Update 2014-09, "Revenue from Contracts with Customers (Topic 606)," which did not have a material impact on our condensed consolidated financial

statements for the three and six months ended June 30, 2018. See Note 2 to our condensed consolidated financial statements for more information. Except as disclosed in Note 2, there were no other material changes to our use of estimates or other critical accounting policies from those disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC on February 28, 2018.

Recently Issued Accounting Standards

See Note 2 of our condensed consolidated financial statements for information related to recently issued accounting standards.

Liquidity and Capital Resources

Working Capital

The following table summarizes our cash and cash equivalents, accounts receivable, net and working capital, for the periods indicated (in thousands):

	June 30, 2018	December 31, 2017
Cash and cash equivalents	$105,959	$ 96,329
Accounts receivable, net	52,553	40,634
Working capital	148,265	119,433

We define working capital as current assets minus current liabilities. Our cash and cash equivalents as of June 30, 2018 are available for working capital purposes. We do not enter into investments for trading purposes, and our investment policy is to invest any excess cash in short term, highly liquid investments that limit the risk of principal loss; therefore, our cash and cash equivalents are held in demand deposit accounts that generate very low returns.

Liquidity and Capital Resources

As of June 30, 2018, we had $106.0 million in cash and cash equivalents. We consider all highly liquid instruments purchased with an original maturity from the date of purchase of three months or less to be cash equivalents. To date, we have principally financed our operations through cash generated by operating activities and, to a lesser extent, through private and public equity financings.

We believe our existing cash and cash equivalents, together with our 2017 Facility, and our future cash flows from operating activities will be sufficient to meet our anticipated operating cash needs for at least the next 12 months. Over the final six months of fiscal year 2018, we expect our capital expenditure requirements to be approximately $8.0 million, primarily related to the continued build out of our leased office space to support our increasing headcount as well as purchases of computer software and equipment. In April 2018, we made a prepayment of $5.2 million for long lead-time parts related to our inventory. Our future working capital and capital expenditure requirements will depend on many factors, including the rate of our revenue growth, the amount and timing of our investments in human resources and capital equipment, future acquisitions and investments, and the timing and extent of our introduction of new solutions and platform and solution enhancements. To the extent our cash and cash equivalents, together with our 2017 Facility, and cash flows from operating activities are insufficient to fund our future activities, we may need to borrow additional funds through our bank credit arrangements or raise funds from public or private equity or debt financings. If we raise additional funds through the incurrence of indebtedness, such indebtedness would likely have rights that are senior to holders of our equity securities and could contain covenants that restrict our operations. Any additional equity financing would be dilutive to our current stockholders.

Sources of Liquidity

Our 2017 Facility is a revolving credit facility with SVB, as administrative agent, and a syndicate of lenders to finance working capital and certain permitted acquisitions and investments. The 2017 Facility is available to us to refinance existing debt and for general corporate and working capital purposes including acquisitions, and has a current borrowing capacity of $125.0 million. We have the option to increase the borrowing capacity of the 2017 Facility to $175.0 million with the consent of the lenders.

As of June 30, 2018, $69.0 million was outstanding under the 2017 Facility, no letters of credit were outstanding and $56.0 million remained available for borrowing under the 2017 Facility. The 2017 Facility contains various financial and other covenants that require us to maintain a maximum consolidated leverage ratio and a fixed charge coverage ratio, and limit our capacity to incur other indebtedness, liens, make certain payments including dividends, and enter into other transactions without approval of the lenders. The 2017 Facility is secured by substantially all of our assets, including our intellectual property. As of June 30, 2018, we were in compliance with all covenants under the 2017 Facility. Our outstanding amounts under the 2017 Facility are due at maturity in October 2022. The 2017 Facility is discussed in more detail below under “Debt Obligations.”

Historical Cash Flows

The following table sets forth our cash flows for the periods indicated (in thousands):

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities	$15,204	$24,736
Cash flows used in investing activities	(6,131)	(164,003)
Cash flows from financing activities	557	67,549

Operating Activities

Cash flows from operating activities have typically been generated from our net income and by changes in our operating assets and liabilities, particularly from accounts receivable and inventory, adjusted for non-cash expense items such as amortization and depreciation, deferred income taxes and stock-based compensation.

For the six months ended June 30, 2018, cash flows from operating activities were $15.2 million, a decrease of $9.5 million from the same period in the prior year, as the result of a $23.1 million reduction in cash from operating assets and liabilities, partially of