

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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 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: 000-18805

**ELECTRONICS FOR IMAGING, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**94-3086355**  
(I.R.S. Employer  
Identification No.)

**6750 Dumbarton Circle, Fremont, CA 94555**  
(Address of principal executive offices) (Zip code)

**(650) 357-3500**  
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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) (Check one):

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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. Yes  No

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

The number of shares of Common Stock outstanding as of April 30, 2018 was 44,720,720.

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Condensed Consolidated Balance Sheets  
(unaudited)**

(in thousands)	March 31, 2018	December 31, 2017
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 163,077	\$ 170,345
Short-term investments, available for sale	140,659	148,697
Accounts receivable, net of allowances of \$29.6 million and \$32.2 million, respectively	251,227	244,416
Inventories	123,824	125,813
Income taxes receivable	10,241	4,565
Assets held for sale	4,200	4,200
Other current assets	49,731	41,799
Total current assets	742,959	739,835
Property and equipment, net	99,333	98,762
Restricted cash equivalents and investments	35,733	32,531
Goodwill	406,876	403,278
Intangible assets, net	111,812	123,008
Deferred tax assets	40,931	45,083
Other assets	27,246	15,504
Total assets	<u>\$ 1,464,890</u>	<u>\$ 1,458,001</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 119,842	\$ 123,935
Accrued and other liabilities	97,657	98,090
Deferred revenue	68,912	55,833
Income taxes payable	5,427	5,309
Total current liabilities	291,838	283,167
Convertible senior notes, net	322,709	318,957
Imputed financing obligation related to build-to-suit lease	13,912	13,944
Noncurrent contingent and other liabilities	24,748	28,801
Deferred tax liabilities	10,375	11,652
Noncurrent income taxes payable	19,666	20,169
Total liabilities	<u>683,248</u>	<u>676,690</u>
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 5,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.01 par value; 150,000 shares authorized; 54,490 and 54,249 shares issued, respectively	545	542
Additional paid-in capital	757,438	745,661
Treasury stock, at cost; 9,685 and 9,070 shares, respectively	(393,175)	(375,574)
Accumulated other comprehensive income	13,211	8,138
Retained earnings	403,623	402,544
Total stockholders' equity	<u>781,642</u>	<u>781,311</u>
Total liabilities and stockholders' equity	<u>\$ 1,464,890</u>	<u>\$ 1,458,001</u>

See accompanying notes to condensed consolidated financial statements.

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**Electronics For Imaging, Inc.**  
**Condensed Consolidated Statements of Operations**  
**(unaudited)**

(in thousands, except per share amounts)	Three months ended March 31,	
	2018	2017
Revenue	\$ 239,866	\$ 228,691
Cost of revenue <sup>(1)</sup>	120,759	105,161
Gross profit	119,107	123,530
Operating expenses:		
Research and development <sup>(1)</sup>	38,279	39,627
Sales and marketing <sup>(1)</sup>	46,680	43,035
General and administrative <sup>(1)</sup>	19,421	21,029
Restructuring and other (Note 11)	4,654	918
Amortization of identified intangibles	12,138	10,778
Total operating expenses	121,172	115,387
Income (loss) from operations	(2,065)	8,143
Interest expense	(4,954)	(4,660)
Interest income and other income, net of expenses	1,289	287
Income (loss) before income taxes	(5,730)	3,770
Benefit from income taxes	2,135	1,017
Net income (loss)	\$ (3,595)	\$ 4,787
Net income (loss) per basic common share	\$ (0.08)	\$ 0.10
Net income (loss) per diluted common share	\$ (0.08)	\$ 0.10
Shares used in basic per-share calculation	45,030	46,551
Shares used in diluted per-share calculation	45,030	47,208

(1) Includes stock-based compensation expense as follows:

	Three months ended March 31,	
	2018	2017
Cost of revenue	\$ 768	\$ 834
Research and development	2,355	3,570
Sales and marketing	1,799	2,295
General and administrative	1,848	3,581

*See accompanying notes to condensed consolidated financial statements.*

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**Electronics For Imaging, Inc.**  
**Condensed Consolidated Statements of Comprehensive Income**  
**(unaudited)**

<u>(in thousands)</u>	<b>Three months ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Net income (loss)	\$(3,595)	\$ 4,787
Net unrealized investment gains (losses):		
Unrealized holding gains (losses), net of tax <sup>(1)</sup>	(548)	135
Reclassification adjustments included in net income (loss), net of tax <sup>(1)</sup>	<u>2</u>	<u>(4)</u>
Net unrealized investment gains (losses)	(546)	131
Currency translation adjustments	5,660	6,174
Net unrealized gains (losses) on cash flow hedges	<u>(41)</u>	<u>55</u>
Comprehensive income	<u>\$ 1,478</u>	<u>\$11,147</u>

(1) Tax effects were less than \$0.1 million for the periods presented above.

*See accompanying notes to condensed consolidated financial statements.*

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**Electronics For Imaging, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
**(unaudited)**

(in thousands)	Three months ended	
	March 31,	
	2018	2017
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (3,595)	\$ 4,787
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	17,106	14,929
Deferred taxes	10,638	(899)
Provisions and releases for bad debt and sales-related allowances	(1,219)	2,822
Provision for inventory obsolescence	1,650	752
Stock-based compensation	6,770	10,280
Non-cash accretion of interest expense on convertible notes and imputed financing obligation	3,802	3,672
Other non-cash charges and credits	172	2,486
Changes in operating assets and liabilities, net of effect of acquired businesses	(29,031)	(23,931)
Net cash provided by operating activities	<u>6,293</u>	<u>14,898</u>
<b>Cash flows from investing activities:</b>		
Purchases of short-term investments	—	(35,149)
Proceeds from sales and maturities of short-term investments	7,318	38,235
Purchases of restricted investments <sup>(1)</sup>	—	(1,038)
Purchases, net of proceeds from sales, of property and equipment	(4,214)	(3,789)
Businesses purchased, net of cash acquired	(252)	(5,700)
Net cash provided by (used for) investing activities <sup>(1)</sup>	<u>2,852</u>	<u>(7,441)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock	5,010	5,855
Purchases of treasury stock and net share settlements	(17,601)	(22,455)
Repayment of imputed financing obligation related to build-to-suit lease	(254)	(411)
Contingent consideration payments related to businesses acquired	(698)	(1,265)
Net cash used for financing activities	<u>(13,543)</u>	<u>(18,276)</u>
Effect of foreign exchange rate changes on cash, cash equivalents and restricted cash equivalents	332	969
Decreases in cash, cash equivalents, and restricted cash equivalents	(4,066)	(9,850)
Cash, cash equivalents, and restricted cash equivalents at beginning of period <sup>(1)</sup>	<u>202,876</u>	<u>165,455</u>
<b>Cash, cash equivalents, and restricted cash equivalents at end of period <sup>(1)</sup></b>	<b><u>\$198,810</u></b>	<b><u>\$155,605</u></b>

(1) Certain prior period amounts have been revised due to the implementation of ASU 2016-18. See Note 1 for details.

*See accompanying notes to condensed consolidated financial statements.*

**Electronics For Imaging, Inc.**  
**Notes to Condensed Consolidated Financial Statements**

**Note 1. Basis of Presentation and Significant Accounting Policies**

*Basis of Presentation*

The accompanying unaudited interim condensed consolidated financial statements (“condensed consolidated financial statements”) include the accounts of Electronics For Imaging, Inc. and its subsidiaries (“EFI” or “Company”). All intercompany accounts and transactions have been eliminated in consolidation.

These condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) for interim financial information, rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial statements, and accounting policies consistent in all material respects with those applied in preparing our audited annual consolidated financial statements included in our Annual Report on Form 10-K, as amended in Amendment No. 1, for the year ended December 31, 2017 (the “2017 Form 10-K”). These condensed consolidated financial statements and accompanying notes should be read in conjunction with our annual consolidated financial statements and the notes included on the 2017 Form 10-K. In the opinion of management, these condensed consolidated financial statements reflect all adjustments, including normal recurring adjustments, management considers necessary for the fair presentation of our financial position, operating results, comprehensive income, and cash flows for the interim periods presented. Our results for the interim periods are not necessarily indicative of results for the entire year.

*Recently Adopted Accounting Pronouncements*

**Revenue Recognition.** Effective January 1, 2018, we adopted Accounting Standards Codification (“ASC”) 606 *Revenue from Contracts with Customers* (“ASC 606”) using the modified retrospective method applied to all incomplete contracts as of the date of initial application. ASC 606 supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition* (“ASC 605”), and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the considerations to which the entity expects to be entitled to in exchange for those goods or services. In addition, ASC 606 requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Effective January 1, 2018, we also adopted ASC 340-40, *Other Assets and Deferred Costs - Contracts with Customers* (“ASC 340-40”) using the modified retrospective method to all incomplete contracts as of the date of initial application. ASC 340-40 requires the deferral of incremental costs of obtaining a contract with a customer.

Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 and ASC 340-40, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC 605. Additional discussion of these recently adopted pronouncements is included below, in Note 3 – Balance Sheet Details, and in Note 4 – Revenue Recognition.

We recorded a net increase to our opening balance of retained earnings of \$4.7 million as of January 1, 2018, after considering the income tax impact, due to the cumulative effect of adopting ASC 606. The adoption impact primarily related to capitalizing customer contract acquisition costs consisting of sales commissions, partially offset by an increase in deferred revenue to reflect the inclusion of significant financing components that will be recognized as interest income as payments are received over the contractual terms, and upfront setup fees that will be recognized ratably over the expected contractual terms.

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The cumulative effect of applying ASC 606 to active contracts as of the adoption date resulted in the following adjustments to the Condensed Consolidated Balance Sheet as of January 1, 2018 (in thousands):

	As previously Reported at December 31, 2017	ASC 606 Adjustments	As Adjusted January 1, 2018
<b>Assets</b>			
Accounts receivable, net	\$ 244,416	\$ 102	\$ 244,518
Other current assets	41,799	(1,628)	40,171
Deferred tax assets	45,083	(1,466)	43,617
Other assets	15,504	8,062	23,566
<b>Liabilities</b>			
Deferred revenue	55,833	(95)	55,738
Noncurrent contingent and other liabilities	28,801	491	29,292
<b>Stockholders' equity:</b>			
Retained earnings	402,544	4,674	407,218

The impact of adopting ASC 606 and ASC 340-40 on our Condensed Consolidated Statement of Operations for the three months ended March 31, 2018 was as follows (in thousands):

	Amounts in Accordance with ASC 606	Amounts in Accordance with ASC 605	Effect of change higher (lower)
<b>Revenue</b>	\$ 239,866	\$ 238,407	\$ 1,459
Cost of revenue	120,759	120,817	(58)
<b>Gross profit</b>	119,107	117,590	1,517
Operating expenses	121,172	121,033	139
<b>Loss from operations</b>	(2,065)	(3,443)	1,378
Interest expenses and other, net	(3,665)	(3,840)	175
Loss before income taxes	(5,730)	(7,283)	1,553
Benefit from income taxes	2,135	2,284	(149)
<b>Net loss</b>	(3,595)	(4,999)	1,404

The impact of adopting ASC 606 and ASC 340-40 on our Condensed Consolidated Balance Sheet at March 31, 2018 was as follows (in thousands):

	Amounts in Accordance with ASC 606	Amounts in Accordance with ASC 605	Effect of change higher (lower)
<b>Assets</b>			
Accounts receivable, net	\$ 251,227	\$ 250,188	\$ 1,039
Other current assets	49,731	51,301	(1,570)
Deferred tax assets	40,931	42,546	(1,615)
Other assets	27,246	19,323	7,923
<b>Liabilities</b>			
Deferred revenue	68,912	69,705	(793)
Noncurrent contingent and other liabilities	24,748	24,257	491
<b>Stockholders' equity:</b>			
Retained earnings	403,623	397,544	6,079

**Income Taxes.** Staff Accounting Bulletin (“SAB”) 118 provides guidance for the application of ASC 740 for a measurement period to complete the accounting for certain elements of the Tax Cut & Jobs Act of 2017 (“2017 Tax Act”). The measurement period is defined as up to one year from the enactment date, which will expire on December 22, 2018. SAB 118 requires that we recognize those income tax effects in our financial statements for which the accounting can be completed, as might be the case for the effect of rate changes on deferred tax assets and deferred tax liabilities. For matters that have not been completed, we are required to recognize provisional amounts to the extent that they are reasonably estimable, adjust them during a measurement period when more information becomes available, and report this information in our financial statements in that period.



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**Restricted Cash.** Accounting Standard Updates (“ASU”) 2016-18, Statement of Cash Flows: Restricted Cash, became effective in the first quarter of 2018 requiring the statement of cash flows to explain the change in cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents are included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts in the statement of cash flows. We previously included the changes in restricted cash equivalents in operating or investing activities in the Condensed Consolidated Statements of Cash Flows. Upon the adoption of ASU 2016-18, changes in restricted cash equivalents related to the off-balance sheet financing arrangement described in Note 8 – Commitments and Contingencies are no longer presented as an investing cash outflow, but instead are presented as a component of the beginning and ending balance of cash, cash equivalents, and restricted cash equivalents in the Condensed Consolidated Statements of Cash Flows. Prior period amounts have been revised to conform to the current year presentation.

### *Reconciliation of Cash, cash equivalents, and restricted cash equivalents*

<u>(in thousands)</u>	<u>March 31, 2018</u>	<u>December 31, 2017</u>	<u>March 31, 2017</u>	<u>December 31, 2016</u>
Cash and cash equivalents	\$ 163,077	\$ 170,345	\$ 151,096	\$ 164,313
Restricted cash equivalents	35,733	32,531	4,509	1,142
Total cash, cash equivalents, and restricted cash equivalents shown in the statement of cash flows	<u>\$ 198,810</u>	<u>\$ 202,876</u>	<u>\$ 155,605</u>	<u>\$ 165,455</u>

**Definition of a Business.** In January 2017, the Financial Accounting Standard Board (“FASB”) issued ASU 2017-01, Business Combinations: Clarifying the Definition of a Business, which significantly narrows how businesses are defined and became effective in the first quarter of 2018. Under ASU 2017-01, when substantially all of the fair value of the gross assets acquired is concentrated in a single asset or group of similar identifiable assets, then the assets acquired do not constitute a business. If substantially all of the fair value of the gross assets acquired is not concentrated in a single asset or group of similar assets, then the assets acquired may constitute a business if certain criteria are met. We must determine whether the acquired gross assets and activities include an input and a “substantive” process that together “significantly” contribute to the ability to create an output. A framework and specific criteria are provided to assist with the evaluation of whether a process is “substantive” and “significantly contributes” to the ability to create an output. “Output” is narrowly defined to be consistent with the description of a performance obligation in the new revenue guidance or this ASU. Missing inputs and processes may not be replaced by integration with our own inputs and processes under the new guidance. The adoption of ASU 2017-01 did not impact our condensed consolidated financial statements as of March 31, 2018 because we did not acquire a business during the first quarter of 2018.

**Nonfinancial Asset Derecognition.** In February 2017, the FASB issued ASU 2017-05, Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets: Clarifying the Scope of Asset Derecognition and Accounting for Partial Sales of Nonfinancial Assets, which clarifies the scope of recent guidance as it relates to nonfinancial asset derecognition and the accounting for partial sales of nonfinancial assets. The ASU conforms the derecognition guidance as it relates to nonfinancial assets with the derecognition guidance in the new revenue standard (ASU 2014-09) and is expected to have a material impact on the accounting for real estate dispositions. ASU 2017-05 became effective in the first quarter of 2018. During the three months ended March 31, 2018, we did not have any non-financial asset derecognition transactions.

**Stock Compensation Modification.** In May 2017, the FASB issued ASU 2017-09, Stock Compensation – Scope of Modification Accounting, which clarifies the scope of modification accounting for share-based payment arrangements, which became effective in the first quarter of 2018. Specifically, we do not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. We elected to adopt this guidance prospectively to awards modified on or after the adoption date. The adoption of ASU 2017-09 did not have a material impact on our condensed consolidated financial statements for the three months ended March 31, 2018.

**Settlement of Convertible Debt.** ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments, issued in August 2016, requires that cash settlements of principal amounts of debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the debt must classify the portion of the principal payment attributable to the accreted interest related to the debt discount as cash outflows from operating activities. This is consistent with the classification of the coupon interest payments.

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ASU 2016-15 became effective in the first quarter of 2018. Accordingly, \$63.6 million of the debt discount attributable to the difference between the 0.75% coupon interest rate on our 0.75% Convertible Senior Notes due 2019 (“Notes”) and the 4.98% (5.46% inclusive of debt issuance costs) effective interest rate will be classified as an operating cash outflow in the Condensed Consolidated Statement of Cash Flows upon cash settlement. If we settle the conversion of the Notes in cash on or prior to the maturity date of September 1, 2019, the cash outflow of \$63.6 million will be recorded in operating activities in the Consolidated Statement of Cash Flows. Convertible debt was not settled as of March 31, 2018. We will apply ASU 2016-15 upon cash settlement.

### *Recent Accounting Pronouncements*

**Lease Arrangements.** Under current guidance, the classification of a lease by a lessee as either an operating or capital lease determines whether an asset and liability is recognized on the balance sheet. ASU 2016-02, Leases, which was issued in February 2016 and will be effective in the first quarter of 2019, requires that a lessee recognize an asset and liability on its balance sheet related to all leases with terms in excess of one year. For all leases, a lessee will be required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. The right-to-use asset represents the right to use the underlying asset during the lease term.

The recognition, measurement, and presentation of expenses and cash flows by a lessee have not significantly changed from previous guidance. There continues to be a differentiation between finance leases and operating leases. The criteria for determining whether a lease is a finance or operating lease are substantially the same as existing guidance except that the “bright line” percentages have been removed. Also, an additional criterion has been added in the new guidance to consider whether the underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term. Additional judgement will be required in applying the new lease guidance.

- For finance leases, interest is recognized on the lease liability separately from depreciation of the right-of-use asset in the statement of operations. Principal repayments are classified within financing activities and interest payments are classified as operating activities in the statement of cash flows.
- For operating leases, a lessee is required to recognize lease expense generally on a straight-line basis. All operating lease payments are classified as operating activities in the statement of cash flows.

The current build-to-suit lease accounting guidance will be rescinded by the new guidance, although simplified guidance will remain regarding lessee control during the construction period. Consequently, the accounting for build-to-suit leases will be the same as operating leases unless the lessee control provisions are applicable.

We have not quantified the impact, but the requirement to recognize a right-of-use asset and a lease liability related to operating leases will have a material impact on our consolidated financial position as reflected in our Consolidated Balance Sheets. As stated above, the recognition, measurement, and presentation of expenses and cash flows by a lessee have not significantly changed from previous guidance; accordingly, the impact on our results of operations as reflected in our Condensed Consolidated Statements of Operations is not expected to be material. We also do not expect a material impact on our results of operations or financial position from adoption of this standard to our lease transactions as lessor.

**Hedge Accounting.** In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities, which amends the hedge accounting recognition and presentation requirements in ASC 815, Derivatives and Hedging.

Under current guidance, changes in the fair value of the effective portion of these contracts are reported as a component of other comprehensive income (“OCI”) and reclassified to operating expense in the periods of payment of the hedged cash flows. The ineffective portion is recognized as a component of interest income and other income, net. Under the new guidance, the entire change in the fair value of hedging instruments designated as cash flow hedges that are included in the assessment of hedge effectiveness will be recorded in OCI. Those amounts are reclassified to earnings in the periods of payment in the same income statement line item as the hedged operating expenses. Upon adoption, a cumulative-effect adjustment will be required for the ineffective portion of derivative contracts designated as cash flow hedges existing at the date of adoption to accumulated OCI with a corresponding adjustment to the retained earnings as of the beginning of the fiscal year of the adoption.

The new guidance continues to require an initial prospective quantitative hedge effectiveness assessment unless the hedging relationship qualifies for the critical-terms-match method or facts and circumstances method, which permit an assumption of perfect hedge effectiveness. After the initial quantitative assessment, the new guidance permits a qualitative ongoing effectiveness assessment for certain hedges if we can reasonably support an expectation of high effectiveness throughout the term of the hedge. The new guidance also requires additional disclosure related to the effect on the income statement of cash flow hedges.

ASU 2017-12 will be effective in the first quarter of 2019. We do not believe this guidance will materially impact our results of operations. We did not have any of these cash flow hedges as of March 31, 2018.

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**Financial Instruments.** ASU 2016-13, Measurement of Credit Losses on Financial Instruments, issued in June 2016, amends current guidance regarding other-than-temporary impairment of available-for-sale debt securities. The new guidance requires an estimate of expected credit loss when fair value is below the amortized cost of the asset without regard for the length of time that the fair value has been below the amortized cost or the historical or implied volatility of the asset. Credit losses on available-for-sale debt securities will be limited to the difference between the security's amortized cost basis and its fair value. The use of an allowance to record estimated credit losses (and subsequent recoveries) will also be required under the new guidance.

ASU 2016-13 will be effective in the first quarter of 2020. We are evaluating its impact on the carrying value of our available-for-sale securities and results of operations.

### *Significant Accounting Policies*

There have been no material changes in our significant accounting policies, as compared to the significant accounting policies described in our 2017 Form 10-K, with the exception of the following:

### *Revenue Recognition*

On January 1, 2018, we adopted ASC 606 using the modified retrospective method applied to those contracts that were not completed as of January 1, 2018. On January 1, 2018, we also adopted ASC 340-40 using the modified retrospective method applied to all contracts as of the date of initial application.

We apply judgment in determining the customer's ability and intention to pay. Judgments are made after considering a variety of factors including the customer's historical payment experience, current creditworthiness, current economic impacts on the customer, past due balances, and significant one-time events or, in the case of a new customer, published credit and financial information.

For customer arrangements that include multiple products or services, judgment is required to determine the standalone selling price ("SSP") for each distinct performance obligation. Where an observable price is not available, we gather all reasonable available data points, consider adjustments based on market conditions, entity-specific factors, and the need to stratify selling prices into meaningful groups (e.g., geographic region) in determining SSP. We allocate the total contract consideration to each distinct performance obligation on a relative SSP basis. Revenue is then recognized in accordance with the timing of the transfer of control to the customer.

Accounting for long-term contracts where we provide information technology system development and implementation services requires significant judgment to estimate total contract revenue and costs. For long-term contracts, we estimate the profit on a contract as the difference between the total estimated revenue and expected costs to complete the services. We then recognize that revenue and profit over the life of the contract. Contract estimates are based on various assumptions to project the outcome of future events that could span several years.

A change in our estimate of total cost to complete could affect the profitability of our contracts. We review and update our contract-related estimates regularly, and the effects of changes, if any, are reflected in the consolidated statements of operations in the period that they are determined. Changes in estimates related to certain types of contracts accounted for using an input method measure of progress, such as cost-to-cost, can occur over the life of a contract for a variety of reasons, including the availability of labor and labor productivity, the nature and complexity of the work to be performed, cost estimates, level of effort and/or other assumptions impacting revenue or cost to perform a contract. We recognize adjustments in estimated profit on contracts under the cumulative catch-up method. Under this method, the impact of the adjustment on profit recorded to date is recognized in the period the adjustment is identified. Revenue and profit in future periods of contract performance is recognized using the adjusted estimate. If at any time, the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the total loss in the quarter it is identified.

Management exercises judgment to determine the period of benefit to amortize contract acquisition costs by considering factors such as expected renewals of customer contracts, duration of customer relationships and our technology development life cycle. Although we believe that the historical assumptions and estimates we have made are reasonable and appropriate, different assumptions and estimates could materially impact our reported financial results. Amortization of deferred contract acquisition costs is included in sales and marketing expense in the consolidated statements of operations. We periodically review these deferred costs to determine whether events or changes in circumstances have occurred that could impact the period of benefit of these deferred contract acquisition costs.

The nature of our products and services are as follows:

**License.** Our software license arrangements provide the customer with the right to install and use functional intellectual property (as it exists at the point in time at which the license is granted) for the duration of the contract term. Under these arrangements, the software is installed at the customer's location. Revenue from distinct software licenses is recognized at the point in time when the software is made available to the customer for download.

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Our software license arrangements are generally comprised of fixed license fees (“license fees”) that are payable upfront, annually, quarterly, or monthly based on negotiated customer payment terms. For software license arrangements in which a significant portion of the license fees are due more than 12 months after the software is delivered to the customer, a significant financing component may exist. The significant financing component is calculated as the difference between the stated value and present value of the software license fees and is recognized as interest income under the effective interest method over the contract term. The total software license fee net of the significant financing component is recognized as revenue at the point in time when the software is made available to the customer for download. In instances where the timing of revenue recognition and the timing of invoicing is one year or less, we follow the practical expedient and do not impute interest for these contracts.

**Maintenance.** Our software license arrangements typically include an initial (bundled) post contract customer support (maintenance or “PCS”) term. Our promise to those customers who elect to purchase PCS represents a distinct, stand-ready performance obligation. Contract consideration is allocated to the PCS based on its relative SSP and revenue is recognized over the PCS term.

**Professional Services.** We provide various professional services to customers, primarily project management, software implementation and training. Revenues from arrangements to provide professional services are generally distinct from the other promises in the contract(s). The majority of our professional services contracts are billed on a time and materials basis and revenue is recognized over time as the services are performed. For contracts billed on a fixed price basis, revenue is recognized in accordance with the input method based on the proportion of services performed to the total fixed fee.

**Software as a Service (“SaaS”).** Our SaaS-based arrangements provide customers with continuous access to the software solutions in the form of a service hosted in the cloud. These arrangements may include initial implementation and setup services and/or on-going support services that represent a single promise (i.e. each individual promised service is not distinct) to provide continuous access to the software solution. Any setup fees associated with our SaaS arrangements, assuming they do not create a material right, are recognized ratably over the contract term. If they do create a material right, we recognize the setup fees over the contract term plus expected renewals.

As the customer simultaneously receives and consumes the benefits as access is provided, our performance obligation under our SaaS-based arrangements is comprised of a series of distinct services delivered over time. Our SaaS-based arrangements may include fixed, variable, or a combination of fixed and variable consideration. Fixed consideration is recognized over the term of the arrangement. Variable consideration in these arrangements is typically a function of a tier-based pricing structure. Variable consideration is estimated at contract inception and allocated to each distinct service period within the series and revenue is recognized as each distinct service period is performed.

**Hardware.** Our hardware, such as Industrial Inkjet printers and Fiery digital front ends (“DFEs”), are generally sold with software that is integral to the functionality of the product. In these cases, the hardware and software license are accounted for as a single performance obligation. The contract consideration is generally in the form of a fixed fee at contract inception and revenue is recognized at the point in time when control is transferred to the customer. Considerations received from customers may include trade-in printers, which are valued at the lower of cost or net realizable value.

We offer shipping and handling services to customers related to the sale of hardware. We have elected the practical expedient to account for shipping and handling activities performed after transferring control of goods to our customer as a cost to fulfill the contract. The cost of shipping and handling will be accrued at the point in which control transfers to the customer and revenue is recognized.

**Ink.** We typically enter into contracts with our existing customer base of installed printers to purchase ink that is not bundled with other deliverables within the contract. The ink is accounted for as a single performance obligation and revenue is recognized at the point in time when control of ink is transferred to the customer.

**Customized Development.** We enter into contracts for professional services required to customize our hardware and software products to allow them to be integrated with a customer’s copier or other product. These integration services are designed to meet the customer’s specifications. The contract pricing is typically at a fixed amount which is paid over the contract term, based on the completion of the phases of the project. The services provided under these contracts result in the transfer of control of the applicable deliverable over time. We recognize revenue on the proportion of labor hours expended and/or costs incurred to the total estimated labor hours and/or costs expected as of the completion of the services.

**Extended Service Plans (“ESP”).** For our hardware arrangements, we enter into contracts with customers to provide services to maintain and repair the hardware for an extended period. ESPs are classified as service-type warranties under ASC 606 as they are sold separately and provide services which are incremental to the assurance that the product will perform to the agreed upon standards. The ESPs are accounted for as a separate performance obligation. Revenue from ESPs are recognized ratably over the contract period as the service is provided.

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(in thousands)	Three months ended	
	March 31,	
	2018	2017
Net cash paid for income taxes	\$ 2,562	\$ 2,092
Cash paid for interest expense	\$ 1,716	\$ 1,661
<b>Non-cash investing and financing activities:</b>		
Property, equipment, and intellectual property received, but not paid	\$ 999	\$ 1,060

**Note 2. Earnings Per Share**

Net income per basic common share is computed using the weighted average number of common shares outstanding during the period. Net income per diluted common share is computed using the weighted average number of common and dilutive potential common shares outstanding during the period. Potential common shares result from the assumed exercise of outstanding common stock options having a dilutive effect using the treasury stock method, non-vested shares of restricted stock having a dilutive effect, non-vested restricted stock for which the performance criteria have been met, shares to be purchased under our Employee Stock Purchase Plan ("ESPP") having a dilutive effect, the assumed release of shares from escrow related to the acquisition of Corrugated Technologies, Inc. ("CTI"), the assumed conversion of our Notes having a dilutive effect using the treasury stock method when the stock price exceeds the conversion price of the Notes, as well as the dilutive effect of our warrants when the stock price exceeds the warrant strike price. Any potential shares that are anti-dilutive as defined in ASC 260, Earnings Per Share, are excluded from the effect of dilutive securities.

Performance-based and market-based restricted stock and stock options that would be issuable if the end of the reporting period were the end of the vesting period, if the result would be dilutive, are assumed to be outstanding for purposes of determining net income per diluted common share as of the later of the beginning of the period or the grant date in accordance with ASC 260-10-45-48. Accordingly, performance-based RSUs, which vested on various dates during the three months ended March 31, 2018 and 2017, based on achievement of specified performance criteria related to revenue, cash flows from operating activities, and non-GAAP operating income targets are included in the determination of net income per diluted common share as of the beginning of each period.

Basic and diluted earnings per share during the periods presented below are reconciled as follows (in thousands, except per share amounts):

	Three months ended March 31,	
	2018	2017
<b>Basic net income per share:</b>		
Net income (loss) available to common shareholders	\$ (3,595)	\$ 4,787
Weighted average common shares outstanding	45,030	46,551
Basic net income (loss) per share	\$ (0.08)	\$ 0.10
<b>Diluted net income per share:</b>		
Net income (loss) available to common shareholders	\$ (3,595)	\$ 4,787
Weighted average common shares outstanding	45,030	46,551
Diluted stock options and non-vested restricted stock	—	657
Weighted average common shares outstanding for purposes of computing diluted net income (loss) per share	45,030	47,208
Diluted net income (loss) per share	\$ (0.08)	\$ 0.10

Potential shares of common stock that were not included in the determination of diluted net income per share for the periods presented because the impact of including them would have been anti-dilutive or performance conditions have not been met, consisted of the following (in thousands):

	Three months ended March 31,	
	2018	2017
Options	69	—
RSUs & PSUs	751	421
ESPP purchase rights	862	477
Total potential shares of common stock excluded from the computation of diluted earnings per share	1,682	898

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The weighted-average number of common shares outstanding does not include the effect of the potential common shares from conversion of our Notes and exercise of our warrants, which were issued in September 2014. The effects of these potentially outstanding shares were not included in the calculation of diluted net income per share because the effect would have been anti-dilutive since the conversion price of the Notes and the strike price of the warrants exceeded the average market price of our common stock. We have the option to pay cash, issue shares of common stock, or any combination thereof for the aggregate amount due upon conversion of the Notes. Our intent is to settle the principal amount of the Notes in cash upon conversion. As a result, only amounts payable in excess of the principal amount of the Notes are considered in diluted net income per share under the treasury stock method. The Note Hedges are not included in the calculation of diluted net income per share because the effect of any exercise of the Note Hedges would be anti-dilutive. Please refer to Note 6 – Convertible Senior Notes, Note Hedges, and Warrants for additional information and definitions.

### **Note 3. Balance Sheet Details**

#### *Inventories*

Inventories as of the periods presented below, are as follows (in thousands):

	<u>March 31,</u> <u>2018</u>	<u>December 31,</u> <u>2017</u>
Raw materials	\$ 56,381	\$ 57,061
Work in process	13,641	9,792
Finished goods	53,802	58,960
Total	<u>\$ 123,824</u>	<u>\$ 125,813</u>

#### *Deferred Contract Acquisition Costs*

ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*, requires the deferral of incremental costs of obtaining a contract with a customer.

Certain of our sales incentive programs that meet the definition of an incremental cost of obtaining a customer contract are required to be capitalized. We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year.

Sales commissions for renewal of a contract may not be commensurate with the commissions paid for the acquisition of the initial contract because commissions are generally not paid on the renewal of the specifically anticipated contract. Sales commissions for initial contracts are deferred and then amortized generally on a straight-line basis over a period of benefit that we have determined to be three to four years. We determined the period of benefit by taking into consideration our customer contracts, our technology, and other factors.

Upon adoption of ASC 340-40 on January 1, 2018, we capitalized \$8.1 million in contract acquisition costs related to contracts that were not completed. For contracts that have durations of less than one year, we follow the practical expedient and expense these costs when incurred.

During the three months ended March 31, 2018, we amortized \$1.1 million of deferred contract acquisition costs. There was no impairment loss in relation to costs capitalized. During the three months ended March 31, 2018, an additional \$1.0 million of contract acquisition costs were capitalized. Deferred contract acquisition costs are included within other noncurrent assets in our Condensed Consolidated Balance Sheets.

#### *Deferred Cost of Revenue*

Deferred cost of revenue related to unrecognized revenue on shipments to customers was \$1.4 and \$3.5 million as of March 31, 2018 and December 31, 2017, respectively, and is included in other current assets in our Condensed Consolidated Balance Sheets.

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### *Product Warranty Reserves*

Product warranty reserves are included in accrued and other liabilities on our Condensed Consolidated Balance Sheets. The changes in product warranty reserves during the periods presented below are as follows (in thousands):

	March 31,	
	2018	2017
<b>Beginning balance</b>	\$16,335	\$10,319
Liability assumed upon acquiring FFPS	—	9,368
Provisions, net of releases	2,972	3,564
Settlements	(4,501)	(4,144)
<b>Ending balance</b>	<u>\$14,806</u>	<u>\$19,107</u>

### *Equipment Subject to Operating Leases, Net*

Equipment subject to operating leases for the periods presented below was as follows (in thousands):

	March 31,	December 31,
	2018	2017
Equipment subject to operating leases	\$ 7,849	\$ 5,432
Accumulated depreciation	(2,207)	(1,927)
Equipment subject to operating leases, net	<u>\$ 5,642</u>	<u>\$ 3,505</u>

Scheduled minimum future rental revenues on operating leases as of March 31, 2018 (in thousands):

Remainder of 2018	\$1,483
2019	2,189
2020	2,678
2021	384
2022	432
	<u>\$7,166</u>

The aggregate minimum future rental revenues on noncancelable leases was \$4.1 million as of December 31, 2017.

### *Accumulated Other Comprehensive Income ("AOCI")*

AOCI classified within stockholders' equity in our Condensed Consolidated Balance Sheets as of the periods presented below is as follows (in thousands):

	March 31,	December 31,
	2018	2017
Net unrealized investment losses	\$ (1,243)	\$ (697)
Currency translation gains	14,454	8,794
Net unrealized gains on cash flow hedges	—	41
Total	<u>\$13,211</u>	<u>\$ 8,138</u>

Amounts reclassified out of AOCI, net of tax, were less than \$0.1 million for the three months ended March 31, 2018 and 2017, respectively, and consisted of unrealized gains and losses from investments in debt securities that are reported within interest income and other income, net of expenses, in our Condensed Consolidated Statements of Operations.

### **Note 4. Revenue Recognition**

We derive our revenue primarily from product revenue, which includes industrial digital inkjet printers, including display graphics, ceramic tile decoration, and textile printers, ink, and parts; print production software; and Fiery DFEs. We receive service revenue from software maintenance and printer maintenance agreements, customer support, training, software development, and consulting.

In accordance with ASC 606, *Revenue from Contracts with Customers*, revenue is recognized when control of the promised products and/or services is transferred to our customers in an amount reflecting the consideration we are entitled to in exchange for those products or services.



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The following table presents our disaggregated revenue by source (in thousands, unaudited). Sales and usage-based taxes are excluded from revenue.

	Three Months Ended March 31, 2018			
	Industrial Inkjet	Productivity Software	Fiery	Total
<b>Major Products and Service Lines:</b>				
Industrial Inkjet				
Printers and parts	\$ 88,374	\$ —	\$ —	\$ 88,374
Ink, supplies, and maintenance	53,835	—	—	53,835
Productivity Software				
Licenses	—	12,656	—	12,656
Professional services	—	7,545	—	7,545
Maintenance and subscriptions	—	23,574	—	23,574
Fiery				
Digital front ends and related products	—	—	50,096	50,096
Maintenance and subscriptions	—	—	3,786	3,786
<b>Total</b>	<b>\$142,209</b>	<b>\$ 43,775</b>	<b>\$53,882</b>	<b>\$239,866</b>
<b>Timing of Revenue Recognition:</b>				
Transferred at a Point in Time	\$136,924	\$ 12,656	\$50,096	\$199,676
Transferred Over Time	5,285	31,119	3,786	40,190
<b>Total</b>	<b>\$142,209</b>	<b>\$ 43,775</b>	<b>\$53,882</b>	<b>\$239,866</b>
<b>Recurring/Non-Recurring:</b>				
Non-Recurring	\$ 88,374	\$ 20,201	\$50,096	\$158,671
Recurring	53,835	23,574	3,786	81,195
<b>Total</b>	<b>\$142,209</b>	<b>\$ 43,775</b>	<b>\$53,882</b>	<b>\$239,866</b>

### Remaining Performance Obligations

Revenue allocated to remaining performance obligations includes deferred revenue and amounts that will be invoiced and recognized as revenue in future periods (“backlog”). Remaining performance obligations were \$121.5 million as of March 31, 2018, of which we expect to recognize substantially all of the revenue over the next 12 months.

### Contract Balances

Timing of revenue recognition may differ from timing of invoicing to customers. Payment terms and conditions vary by contract type. Deferred revenue (contract liability) represents amounts received in advance, or invoiced in advance, for product support contracts, software customer support contracts, consulting and integration projects, SaaS arrangements, or product sales. We defer these amounts when we collect or invoice the customer and then generally recognize revenue either ratably over the support contract term, upon performing the related services, under the cost-to-cost method, or in accordance with our revenue recognition policy. Revenue recognized during the three months ended March 31, 2018, which was included in deferred revenue at December 31, 2017, was \$27.3 million.

Unbilled accounts receivable (contract assets) represents contract assets for revenue that have been recognized in advance of billing the customer, which is common for long-term contracts. Billing requirements vary by contract but are generally structured around the completion of certain development milestones. Unbilled accounts receivable at December 31, 2017, that were transferred to accounts receivable during the three months ended March 31, 2018, was \$12.8 million.

The following table reflects the balances in our unbilled accounts receivable and our deferred revenue as of the periods presented below (in thousands):

	March 31, 2018	January 1, 2018
Unbilled accounts receivables - current	\$ 29,962	\$ 27,419
Unbilled accounts receivables - noncurrent	9,381	7,678
Deferred revenue - current	68,912	55,738
Deferred revenue - noncurrent	552	565



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**Note 5. Investments and Fair Value Measurements**

We invest our excess cash on deposit with major banks in money market, United States (“U.S.”) Treasury and government-sponsored entity, corporate, municipal government, asset-backed, and mortgage-backed residential debt securities. By policy, we invest primarily in high-grade marketable securities. We are exposed to credit risk in the event of default by the financial institutions or issuers of these investments to the extent of amounts recorded in our Condensed Consolidated Balance Sheets.

We consider all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents. Typically, the cost of these investments has approximated fair value. Marketable investments with a maturity greater than three months are classified as available-for-sale short-term investments. Available-for-sale securities are stated at fair value with unrealized gains and losses reported as a separate component of OCI, adjusted for deferred income taxes. The credit portion of any other-than-temporary impairment is included in net income. Realized gains and losses on sales of financial instruments are recognized upon sale of the investments using the specific identification method. Our available-for-sale short-term investments as of the periods presented below are summarized as follows (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
<b>March 31, 2018</b>				
U.S. Government and sponsored entities	\$ 59,831	\$ —	\$ (811)	\$ 59,020
Corporate debt securities	72,645	—	(779)	71,866
Municipal securities	383	—	(3)	380
Asset-backed securities	9,166	41	(87)	9,120
Mortgage-backed securities – residential	275	—	(2)	273
Total short-term investments	<u>\$ 142,300</u>	<u>\$ 41</u>	<u>\$ (1,682)</u>	<u>\$ 140,659</u>
<b>December 31, 2017</b>				
U.S. Government and sponsored entities	\$ 59,824	\$ —	\$ (660)	\$ 59,164
Corporate debt securities	79,356	—	(450)	78,906
Municipal securities	382	—	(2)	380
Asset-backed securities	9,808	44	(47)	9,805
Mortgage-backed securities – residential	445	—	(3)	442
Total short-term investments	<u>\$ 149,815</u>	<u>\$ 44</u>	<u>\$ (1,162)</u>	<u>\$ 148,697</u>

The fair value and duration that investments, including cash equivalents, have been in a gross unrealized loss position as of the periods presented below are as follows (in thousands):

	Less than 12 Months		More than 12 Months		TOTAL	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>March 31, 2018</b>						
U.S. Government and sponsored entities	\$22,912	\$ (319)	\$35,948	\$ (491)	\$ 58,860	\$ (810)
Corporate debt securities	37,448	(394)	34,090	(386)	71,538	(780)
Municipal securities	377	(3)	—	—	377	(3)
Asset-backed securities	6,317	(64)	2,728	(23)	9,045	(87)
Mortgage-backed securities – residential	106	(1)	144	(1)	250	(2)
Total	<u>\$67,160</u>	<u>\$ (781)</u>	<u>\$72,910</u>	<u>\$ (901)</u>	<u>\$140,070</u>	<u>\$ (1,682)</u>
<b>December 31, 2017</b>						
U.S. Government and sponsored entities	\$23,023	\$ (206)	\$35,989	\$ (454)	\$ 59,012	\$ (660)
Corporate debt securities	45,857	(207)	32,634	(243)	78,491	(450)
Municipal securities	378	(2)	—	—	378	(2)
Asset-backed securities	6,779	(31)	2,947	(16)	9,726	(47)
Mortgage-backed securities – residential	162	(2)	142	(1)	304	(3)
Total	<u>\$76,199</u>	<u>\$ (448)</u>	<u>\$71,712</u>	<u>\$ (714)</u>	<u>\$147,911</u>	<u>\$ (1,162)</u>

For fixed income securities that have unrealized losses as of March 31, 2018, we have determined that we do not have the intent to sell any of these investments and it is not more likely than not that we will be required to sell any of these investments before recovery of the entire amortized cost basis. We have evaluated these fixed income securities and determined that no credit losses exist. Accordingly, management has determined that the unrealized losses on our fixed income securities as of March 31, 2018, were temporary in nature.

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Amortized cost and estimated fair value of investments as of March 31, 2018, are summarized by maturity date as follows (in thousands):

	<u>Amortized cost</u>	<u>Fair value</u>
Mature in less than one year	\$ 56,666	\$ 56,348
Mature in one to three years	85,634	84,311
Total short-term investments	<u>\$ 142,300</u>	<u>\$140,659</u>

Net realized gains from sales of investments of less than \$0.1 million were recognized in interest income and other income, net, during the three months ended March 31, 2018 and 2017, respectively. Net unrealized losses of \$1.6 and \$1.1 million were included in OCI in the accompanying Condensed Consolidated Balance Sheets as of March 31, 2018, and December 31, 2017, respectively.

### *Fair Value Measurements*

ASC 820, Fair Value Measurements, identifies fair value as the exchange price, or exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a three-tier fair value hierarchy as follows:

Level 1: Inputs that are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date;

Level 2: Inputs that are other than quoted prices included within Level 1, that are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date for the duration of the instrument's anticipated life or by comparison to similar instruments; and

Level 3: Inputs that are unobservable or reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. These include management's own judgments about market participant assumptions developed based on the best information available in the circumstances.

We utilize the market approach to measure the fair value of our fixed income securities. The market approach is a valuation technique that uses the prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The fair value of our fixed income securities is obtained using readily-available market prices from a variety of industry standard data providers, large financial institutions, and other third-party sources for the identical underlying securities. The fair value of our investments in certain money market funds is expected to maintain a net asset value of \$1 per share and, as such, is priced at the expected market price.

We obtain the fair value of our Level 2 financial instruments from several third-party asset managers, custodian banks, and the accounting service providers. Independently, these service providers use professional pricing services to gather pricing data, which may include quoted market prices for identical or comparable instruments or inputs other than quoted prices that are observable either directly or indirectly. As part of this process, we engaged a pricing service to assist management in its pricing analysis and assessment of other-than-temporary impairment. All estimates, key assumptions, and forecasts were either provided by or reviewed by us. While we chose to utilize a third-party pricing service, the impairment analysis and related valuations represent conclusions of management and not conclusions or statements of any third party.

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Our investments and liabilities measured at fair value have been presented in accordance with the fair value hierarchy specified in ASC 820, as of the periods presented below, in order of liquidity as follows (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
<b>March 31, 2018</b>				
<b>Assets:</b>				
Money market funds	\$ 6,228	\$ 6,228	\$ —	\$ —
U.S. Government and sponsored entities	59,020	33,207	25,813	—
Corporate debt securities	71,866	—	71,866	—
Municipal securities	380	—	380	—
Asset-backed securities	9,120	—	9,072	48
Mortgage-backed securities – residential	273	—	273	—
	<u>\$146,887</u>	<u>\$ 39,435</u>	<u>\$107,404</u>	<u>\$ 48</u>
<b>Liabilities:</b>				
Contingent consideration, current and noncurrent	\$ 33,995	\$ —	\$ —	\$ 33,995
Self-insurance	1,247	—	—	1,247
	<u>\$ 35,242</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 35,242</u>
<b>December 31, 2017</b>				
<b>Assets:</b>				
Money market funds	\$ 9,897	\$ 9,897	\$ —	\$ —
U.S. Government and sponsored entities	59,164	33,261	25,903	—
Corporate debt securities	78,906	—	78,906	—
Municipal securities	380	—	380	—
Asset-backed securities	9,805	—	9,754	51
Mortgage-backed securities – residential	442	—	442	—
	<u>\$158,594</u>	<u>\$ 43,158</u>	<u>\$115,385</u>	<u>\$ 51</u>
<b>Liabilities:</b>				
Contingent consideration, current and noncurrent	\$ 35,702	\$ —	\$ —	\$ 35,702
Self-insurance	902	—	—	902
	<u>\$ 36,604</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 36,604</u>

Money market funds have been classified as cash equivalents as of March 31, 2018, and December 31, 2017, respectively.

Investments are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices or alternative pricing sources with reasonable levels of price transparency. Investments in U.S. Treasury obligations and overnight money market mutual funds have been classified as Level 1 because these securities are valued based on quoted prices in active markets or are actively traded at \$1.00 net asset value. There have been no transfers between Level 1 and 2 during the three months ended March 31, 2018 and 2017.

Government agency investments and corporate debt instruments, including investments in asset-backed and mortgage-backed securities, have generally been classified as Level 2 because markets for these securities are less active or valuations for such securities utilize significant inputs, which are directly or indirectly observable. We hold asset-backed securities with income payments derived from and collateralized by a specified pool of underlying assets. Asset-backed securities in the portfolio are predominantly collateralized by credit cards and auto loans. We also hold two asset-backed securities collateralized by mortgage loans, which have been fully reserved.

### Liabilities for Contingent Consideration

Acquisition-related liabilities for contingent consideration (i.e., earnouts) are related to the purchase business combinations of Escada Innovations Limited and Escada Systems, Inc. (collectively, “Escada”) and Generation Digital Solutions, Inc. (“Generation Digital”), in 2017; Optitex Ltd. (“Optitex”) and Rialco Limited (“Rialco”) in 2016; Shuttleworth Business Systems Limited and CDM Solutions Limited (collectively, “Shuttleworth”), CTI, and Reggiani Macchine SpA (“Reggiani”) in 2015; and PrintLeader Software (“PrintLeader”) in 2013.

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The fair value of these earnouts is estimated to be \$34.0 and \$35.7 million as of March 31, 2018, and December 31, 2017, respectively, by applying the income approach in accordance with ASC 805-30-25-5. Key assumptions include risk-free discount rates between 0.6% and 4.98%, as well as probability-adjusted revenue, gross profit, and direct operating income using the Monte Carlo valuation method. Probability-adjusted revenue, gross profit, and direct operating income are significant inputs that are not observable in the market, which ASC 820-10-35 refers to as Level 3 inputs. These contingent liabilities have been reflected in the Condensed Consolidated Balance Sheet as of March 31, 2018, as current and noncurrent liabilities of \$16.0 and \$18.0 million, respectively.

Changes in the fair value of contingent consideration are summarized as follows (in thousands):

<u>Liability for Contingent Consideration</u>	
Fair value of contingent consideration at January 1, 2017	\$ 56,463
Fair value of Generation Digital contingent consideration at August 14, 2017	3,600
Fair value of Escada contingent consideration at October 1, 2017	2,049
Escrow adjustment for Reggiani acquisition	(4,711)
Changes in valuation	4,761
Earnout accretion	1,711
Payments and settlements	(30,924)
Foreign currency adjustment	2,753
Fair value of contingent consideration at December 31, 2017	\$ 35,702
Changes in valuation	(1,459)
Earnout accretion	230
Payments	(724)
Foreign currency adjustment	246
Fair value of contingent consideration at March 31, 2018	<u>\$ 33,995</u>

The Generation Digital and Shuttleworth earnout performance probabilities decreased in 2018 based on recent actual and updated forecasted financial performance. The Optitex, CTI and Rialco earnout performance probabilities increased during 2017, while the Shuttleworth earnout performance probability decreased. In accordance with ASC 805-30-35-1, changes in the fair value of contingent consideration subsequent to the acquisition date have been recognized in general and administrative expense.

Earnout payments and settlements during the three months ended March 31, 2018 of \$0.7 million are primarily related to the previously accrued Shuttleworth contingent consideration liability. Earnout payments during the year ended December 31, 2017 of \$21.5, \$6.8, \$1.3, and \$1.2 million were primarily related to the previously accrued Reggiani, Optitex, Rialco, and Shuttleworth contingent consideration liabilities, respectively.

The primary inputs to the fair value measurement of contingent consideration liability are the discount rate and probability-adjusted revenue or earnings targets specified in the acquisition agreements. Accordingly, we reviewed the sensitivity of the fair value measurement to changes in these inputs. We assessed the probability of achieving the revenue performance targets for contingent consideration associated with each acquisition at percentage levels between 50% and 100% as of each respective acquisition date based on an assessment of the historical performance of each acquired entity, our current expectations of future performance, and other relevant factors. A change in probability-adjusted revenue of five percentage points from the level assumed in the current valuations would result in an increase in the fair value of contingent consideration of \$1.8 million or a decrease in the fair value of contingent consideration of \$2.3 million, resulting in a corresponding adjustment to general and administrative expense. A change in the discount rate of one percentage point would result in an increase in the fair value of contingent consideration of \$0.3 million or a decrease of \$0.3 million. The potential undiscounted amount of future contingent consideration cash payments that we could be required to make related to our business acquisitions, beyond amounts currently accrued, is \$10.6 million as of March 31, 2018.

### *Fair Value of Derivative Instruments*

We utilize the income approach to measure the fair value of our derivative assets and liabilities. The income approach uses pricing models that rely on market observable inputs such as yield curves, currency exchange rates, and forward prices, and are therefore classified as Level 2 measurements. The notional amount of our derivative assets and liabilities was \$243.5 and \$239.4 million as of March 31, 2018 and December 31, 2017, respectively. We did not have any cash flow hedges as of March 31, 2018. The fair value of our derivative assets and liabilities that were designated for cash flow hedge accounting treatment having notional amounts of \$3.9 million as of December 31, 2017 was not material.

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### *Fair Value of Convertible Senior Notes*

In September 2014, we issued \$345 million aggregate principal amount of our Notes. The Notes are carried at their original issuance value, net of unamortized debt discount, and are not marked to market each period. The fair value of the Notes as of March 31, 2018 was approximately \$334.7 million and was considered a Level 2 fair value measurement. Fair value was estimated based upon actual quotations obtained at the end of the reporting period or the most recent date available. A substantial portion of the market value of our Notes in excess of the outstanding principal amount relates to the conversion premium.

### **Note 6. Convertible Senior Notes, Note Hedges, and Warrants**

#### *0.75% Convertible Senior Notes Due 2019*

In September 2014, we completed a private placement of \$345 million principal amount of 0.75% Convertible Senior Notes due September 1, 2019. The Notes were sold to the initial purchasers for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from this offering were approximately \$336.3 million, after deducting the initial purchasers' commissions and the offering expenses paid by us. We used approximately \$29.4 million of the net proceeds to purchase the Note Hedges described below, net of the proceeds from the Warrant transactions also described below.

The Notes are senior unsecured obligations of EFI with interest payable semiannually in arrears on March 1 and September 1 of each year, commencing March 1, 2015. The Notes are not callable and will mature on September 1, 2019, unless previously purchased or converted in accordance with their terms prior to such date. Holders of the Notes who convert in connection with a "fundamental change," as defined in the indenture governing the Notes ("Indenture"), may require us to purchase for cash all or any portion of their Notes at a purchase price equal to 100 percent of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any.

The initial conversion rate is 18.9667 shares of common stock per \$1,000 principal amount of Notes, which is equivalent to an initial conversion price of approximately \$52.72 per share of common stock. Upon conversion of the Notes, holders will receive cash, shares of common stock or a combination thereof, at our election. Our intent is to settle the principal amount of the Notes in cash upon conversion. If the conversion value exceeds the principal amount, we would deliver shares of our common stock for our conversion obligation in excess of the aggregate principal amount. As of March 31, 2018, none of the conditions listed below allowing holders of the Notes to convert had been met.

Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Holders may convert their Notes only under the following circumstances:

- if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any five consecutive trading day period ("Notes Measurement Period") in which the "trading price" (as the term is defined in the Indenture) per \$1,000 principal amount of Notes for each trading day of such Notes Measurement Period was less than 98% of the product of the last reported stock price on such trading day and the conversion rate on each such trading day;
- upon the occurrence of specified corporate events; or
- at any time on or after March 1, 2019 until the close of business on the second scheduled trading day immediately preceding the maturity date.

We separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the estimated fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount ("debt discount") is amortized to interest expense over the term of the Notes using the effective interest method with an effective interest rate of 4.98% per annum (5.46% inclusive of debt issuance costs). The equity component is not remeasured if it continues to meet the conditions for equity classification.

We allocated the total transaction costs incurred by the Notes issuance to the liability and equity components based on their relative values. Issuance costs of \$7.0 million attributable to the \$281.4 million liability component are being amortized to expense over the term of the Notes, and issuance costs of \$1.6 million attributable to the \$63.6 million equity component were offset against the equity component in stockholders' equity. Additionally, we recorded a deferred tax liability of \$23.7 million on the debt discount, which is not deductible for tax purposes.

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The Notes consist of the following as of the periods presented below (in thousands):

	March 31, 2018	December 31, 2017
Liability component	\$345,000	\$ 345,000
Debt discount, net of amortization	(19,823)	(23,178)
Debt issuance costs, net of amortization	(2,468)	(2,865)
Net carrying amount	<u>\$322,709</u>	<u>\$ 318,957</u>
Equity component	\$ 63,643	\$ 63,643
Less: debt issuance costs allocated to equity	(1,582)	(1,582)
Net carrying amount	<u>\$ 62,061</u>	<u>\$ 62,061</u>

Interest expenses recognized related to the Notes during the periods presented below were as follows (in thousands):

	Three months ended	
	March 31, 2018	March 31, 2017
0.75% coupon	\$ 647	\$ 640
Amortization of debt discount	3,355	3,142
Amortization of debt issuance costs	397	374
Total	<u>\$ 4,399</u>	<u>\$ 4,156</u>

### *Note Hedges*

We paid an aggregate of \$63.9 million in convertible note hedge transactions with respect to our common stock (“Note Hedges”) in September 2014. The Note Hedges will expire upon maturity of the Notes. The Note Hedges are intended to offset the potential dilution upon conversion and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of the Notes in the event that the market value per share of our common stock, as measured under the terms of the Note Hedges, is greater than the strike price of the Note Hedges. The strike price of the Note Hedges initially corresponds to the conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion price of the Notes. The Note Hedges are separate transactions and are not part of the Notes. Holders of the Notes will not have any rights with respect to the Note Hedges.

### *Warrants*

Concurrently with entering into the Note Hedges, we separately entered into warrant transactions (“Warrants”), whereby we sold Warrants to acquire shares of our common stock at a strike price of \$68.86 per share. We received aggregate proceeds of \$34.5 million from the sale of the Warrants. If the average market value per share of our common stock for the reporting period, as measured under the Warrants, exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on our earnings per share. The Warrants are separate transactions and are not part of the Notes or the Note Hedges and are accounted for as a component of additional paid-in capital. Holders of the Notes and Note Hedges will not have any rights with respect to the Warrants.

### **Note 7. Income taxes**

We recognized a tax benefit of \$2.1 and \$1.0 million on pretax loss of \$5.7 million and pretax income of \$3.8 million during the three months ended March 31, 2018 and 2017, respectively. The benefits and provisions for income taxes before discrete items reflected in the table below were \$3.4 and \$1.1 million during the three months ended March 31, 2018 and 2017, respectively. The decrease in the provisions for income taxes before discrete items for the three months ended March 31, 2018, compared with the same periods in the prior year, is primarily due to decreased profitability before income taxes.

Primary differences between our provision for income taxes before discrete items and the income tax provision at the U.S. statutory rate include taxes on permanently reinvested foreign earnings, the tax effects of stock-based compensation expense pursuant to ASC 718-740, Stock Compensation – Income Taxes, which are non-deductible for tax purposes, and the U.S. Research and Development Credit.

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Our tax provision for (benefit from) income taxes before discrete items are reconciled to our recorded benefit from income taxes, for the periods presented below, as follows (in thousands):

	Three months ended March 31,	
	2018	2017
Provision for (benefit from) income taxes before discrete items	\$ (3,420)	\$ 1,096
Interest related to unrecognized tax benefits	112	34
Benefit related to stock based compensation, including ESPP dispositions	(24)	(1,568)
Benefit from reversals of accrued interest related to uncertain tax positions	(150)	—
Benefit from reassessment of taxes upon filing tax returns	—	(85)
Benefit from reassessment of taxes upon tax law change	161	(494)
Provision for deemed repatriation transition tax	1,222	—
Benefit from income taxes	<u>\$ (2,099)</u>	<u>\$ (1,017)</u>

On December 22, 2017, the 2017 Tax Act was enacted by the U.S. government. The 2017 Tax Act made broad and complex changes to the U.S. tax code that impact the three months ended March 31, 2018 and year ended December 31, 2017, including, but not limited to lowering the U.S. corporate income tax from 35% to 21% effective January 1, 2018, imposing a one-time deemed repatriation transition tax and the remeasurement of U.S. deferred tax assets and liabilities. The enactment of the 2017 Tax Act requires companies, under ASC 740, to recognize the effects of changes in tax law and rates on deferred tax assets and liabilities and the retroactive effects of changes in tax laws in the period in which the new legislation is enacted. The effects of these changes in tax law are recorded as a component of our tax provision, regardless of the category of pre-tax income or loss to which the deferred taxes relate.

The SEC issued SAB 118, which allows us to record a provisional estimate of the income tax effects of the 2017 Tax Act in the period in which we can make a reasonable estimate of its effects. We have recorded a \$27.5 million tax charge in the year ended December 31, 2017 as a provisional estimate. This includes an estimated charge of \$17.0 million related to the deemed repatriation transition tax, which is comprised of a gross transition tax of \$27.0 million offset by foreign tax credits of \$10.0 million. In addition, we recorded a \$10.5 million charge related to the remeasurement of U.S. deferred tax assets and liabilities in the year ended December 31, 2017. While we have calculated a reasonable estimate of the impact of the U.S. tax rate reduction and the amount of the deemed repatriation transition tax, we are gathering additional information to refine and finalize our calculation of the impacts of the 2017 Tax Act on our U.S. deferred tax assets and liabilities, the deemed repatriation transition tax, and other provisions associated with the 2017 Tax Act. We accrued an additional \$1.2 million for state taxes related to the deemed repatriation transition tax in the three months ended March 31, 2018. As we obtain additional information, we will record adjustments in subsequent periods and will finalize the calculation of the income tax effects of the 2017 Tax Act in the fourth quarter of 2018, or in an earlier quarter if our analysis is complete.

The 2017 Tax Act also created a global intangible low-tax income (“GILTI”) provision, which is a minimum tax on certain foreign earnings, commencing in the year ending December 31, 2018. The amount of future U.S. inclusions in taxable income related to GILTI depends on our current structure, estimated future results of global operations, and our intent and ability to modify our structure and/or our business. We are not yet able to provide a reasonable estimate of the effect of this provision of the 2017 Tax Act. Any subsequent adjustment to the deferred tax amounts related to GILTI (or other computations) will be recorded as a tax expense in the quarter of 2018 when the analysis is complete.

As of March 31, 2018, and December 31, 2017, gross unrecognized benefits that would affect the effective tax rate if recognized were \$32.8 and \$33.9 million, respectively. Over the next twelve months, our existing tax positions will continue to generate increased liabilities for unrecognized tax benefits. It is reasonably possible that our gross unrecognized tax benefits will decrease up to \$4.4 million in the next twelve months. These adjustments, if recognized, would positively impact our effective tax rate, and would be recognized as additional tax benefits in our Condensed Consolidated Statements of Operations.

In accordance with ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, Similar Tax Loss, or Tax Credit Carryforward Exists, \$16.4 million of gross unrecognized tax benefits were offset against deferred tax assets as of March 31, 2018, and the remaining \$16.4 million has been recorded as noncurrent income taxes payable.

We are subject to examination by the Internal Revenue Service (“IRS”) for the 2014-2016 tax years, state tax jurisdictions for the 2013-2016 tax years, the Netherlands tax authority for the 2014-2016 tax years, the Spanish tax authority for the 2013-2016 tax years, the Israel tax authority for the 2014-2016 tax years, and the Italian tax authority for the 2013-2016 tax years.



## **Note 8. Commitments and Contingencies**

### *Contingent Consideration*

We are required to make payments to the former stockholders of acquired companies based on the achievement of specified performance targets as more fully explained in Note 5 – Investments and Fair Value Measurements.

### *Lease Commitments and Contractual Obligations*

As of March 31, 2018, we have leased certain of our current facilities and vehicles under noncancelable operating lease agreements. We are required to pay property taxes, insurance, and nominal maintenance costs for certain of these facilities and vehicles, and any increases over the base year of these expenses on the remainder of our facilities and vehicle leases.

### *Assets Held for Sale*

During the fourth quarter of 2017, management approved a plan to sell approximately 31.5 acres of land and two manufacturing buildings located at One Vutek Place and 189 Waukegan Street, Meredith, New Hampshire, consisting of 163,000 total square feet. Assets previously recorded within property and equipment, net, of \$5.1 million consisting of \$4.5 million net book value of the facilities and \$0.6 million of related land have been reclassified as assets held for sale in our Condensed Consolidated Balance Sheet as of December 31, 2017 and March 31, 2018. Management has entered into an agreement to sell a portion of these facilities subject to due diligence and customary closing procedures. Management expects the sale of both of these facilities to be completed by December 31, 2018.

### *Off-Balance Sheet Financing – Lease Arrangements*

On August 26, 2016, we entered into a lease agreement and have accounted for a lease term of 48.5 years, inclusive of two renewal options of 5.0 and 3.5 years, with the City of Manchester to lease 16.9 acres adjacent to the Manchester Regional Airport. The land is subleased to MUFG Americas Capital Leasing & Finance, LLC (“MUFG”), formerly Bank of Tokyo – Mitsubishi UFJ Leasing & Finance LLC during the term of the lease related to the manufacturing facility that is being constructed on the site, which is described below. Minimum lease payments are \$13.3 million during the entire 48.5-year term of the land lease, excluding six months of the land lease that are financed into the manufacturing facility lease.

On August 26, 2016, we entered into a six-year lease with MUFG whereby a 225,000-square foot manufacturing and warehouse facility is under construction related to our super-wide format industrial digital inkjet printer business in the Industrial Inkjet operating segment at a projected cost of \$40 million and a construction period of 20 months. Minimum lease payments during the initial six-year term are \$1.8 million. Upon completion of the initial six-year term, we have the option to renew the lease, purchase the facility, or return the facility to MUFG subject to an 89% residual value guarantee under which we would recognize additional rent expense in the form of a variable rent payment. We have assessed our exposure in relation to the residual value guarantee and believe that there is no deficiency to the guaranteed value with respect to funds expended by MUFG as of March 31, 2018. We are treated as the owner of the facility for federal income tax purposes.

During the construction period, we are required under the terms of our agreement with MUFG to maintain restricted cash equivalents or restricted investments equal to the amount expended to date on the construction of the building. The funds are invested in \$35.7 million of cash equivalents with a third-party trustee and are restricted during the construction period. Upon completion of construction, the funds will be released as cash and cash equivalents. The portion of released funds that represents 100% of the total expenditures made by MUFG will be deposited with MUFG and restricted as collateral until the end of the underlying lease period.

We have determined that the lease agreement does not qualify as a variable interest entity under ASC 810-10, Consolidation, and as such, we are not required to consolidate the VIE in our condensed consolidated financial statements.

### *Legal Proceedings*

We may be involved, from time to time, in a variety of claims, lawsuits, investigations, or proceedings relating to contractual disputes, securities laws, intellectual property rights, employment, or other matters that may arise in the normal course of business. We assess our potential liability in each of these matters by using the information available to us. We develop our views on estimated losses in consultation with inside and outside counsel, which involves a subjective analysis of potential results and various combinations of appropriate litigation and settlement strategies. We accrue estimated losses from contingencies if a loss is deemed probable and can be reasonably estimated.



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As of March 31, 2018, we are subject to the matters discussed below:

### **Matan Digital Printing (“MDG”) Matter**

EFI acquired Matan Digital Printers (“Matan”) in 2015 from sellers (the “2015 Sellers”) that acquired Matan Digital Printing Ltd. from other sellers in 2001 (the “2001 Sellers”). The 2001 Sellers have asserted a claim against the 2015 Sellers and Matan asserting that they are entitled to a portion of the 2015 Sellers’ proceeds from EFI’s acquisition. The 2015 Sellers dispute this claim and have agreed to indemnify EFI against the 2001 Sellers’ claim.

Although we are fully indemnified and we do not believe that it is probable that we will incur a loss, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Accordingly, it is reasonably possible that we could incur a material loss in this matter. We estimate the range of loss to be between one dollar and \$10.1 million. If we incur a loss in this matter, it will be offset by a receivable of an equal amount representing a claim for indemnification against the escrow account established in connection with the Matan acquisition.

### **Purported Class Action Lawsuit**

On August 10, 2017, a putative class action was filed against the Company and its two named executive officers in the United States District Court for the District of New Jersey, captioned *Pipitone v. Electronics For Imaging, Inc.*, No. 2:17-cv-05992 (D.N.J.). A First Amended Complaint was filed on February 20, 2018. The plaintiffs allege, among other things, that statements by the Company and its officers about the Company’s financial reporting, revenue recognition, internal controls, and disclosure controls and procedures were false or misleading. The complaint seeks an unspecified amount of damages, interest, attorneys’ fees, and other costs, on behalf of a putative class of individuals and entities that purchased or otherwise acquired EFI securities from February 22, 2017 through August 3, 2017.

At this time, we do not believe it is probable that we will incur a material loss in this matter. However, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Because this matter is in the preliminary stages, we are not yet in a position to estimate the amount or range of reasonably possible loss that may be incurred.

### **Purported Derivative Shareholder Lawsuits**

On August 22, 2017, a purported derivative shareholder complaint was filed in the Superior Court of the State of California for the County of Alameda captioned *Schiffmiller v. Gecht*, No. RG17873197. A First Amended Complaint was filed on April 13, 2018. The complaint makes claims derivatively and on behalf of the Company as nominal defendant against the Company’s named executive officers and directors for alleged breaches of fiduciary duties and unjust enrichment, and alleges, among other things, that statements by the Company and its officers about the Company’s financial reporting, revenue recognition, internal controls, and disclosure controls and procedures were false or misleading. The complaint alleges the Company has suffered damage as a result of the individual defendants’ alleged actions, and seeks an unspecified amount of damages, restitution, and declaratory and other relief. The derivative action has been stayed pending the resolution of the *Pipitone* class action described above.

At this time, we do not believe it is probable that we will incur a material loss in this matter. However, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Because this matter has been stayed pending resolution of the *Pipitone* class action described above, we are not yet in a position to estimate the amount or range of reasonably possible loss that may be incurred.

### **Other Matters**

As of March 31, 2018, we were subject to various other claims, lawsuits, investigations, and proceedings in addition to the matter discussed above. There is at least a reasonable possibility that additional losses may be incurred in excess of the amounts that we have accrued. However, we believe that these claims are not material to our financial statements or the range of reasonably possible losses is not reasonably estimable. Litigation is inherently unpredictable, and while we believe that we have valid defenses with respect to legal matters pending against us, our financial statements could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies or because of the diversion of management’s attention and the incurrence of significant expenses.

### **Note 9. Segment Information and Geographic Data**

Operating segment information is required to be presented based on the internal reporting used by the chief operating decision making group (“CODM”) to allocate resources and evaluate operating segment performance. Our CODM is comprised of our Chief Executive Officer and Chief Financial Officer. The CODM is focused on assessment and resource allocation among the Industrial Inkjet, Productivity Software, and Fiery operating segments.

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**Industrial Inkjet** consists of our VUTEk super-wide and wide format display graphics, Nozomi corrugated packaging and display, Reggiani textile, and Cretaprint ceramic tile decoration and building material industrial digital inkjet printers; digital ultra-violet (“UV”) curable, light-emitting diode (“LED”) curable, ceramic, water-based, and thermoforming and specialty ink, as well as a variety of textile ink including dye sublimation, pigmented, reactive dye, acid dye, pure disperse dye, water-based dispersed printing ink, supplies, and coatings; digital inkjet printer parts; and professional services. Printing surfaces include paper, vinyl, corrugated, textile, glass, plastic, aluminum composite, ceramic tile, wood, and many other flexible and rigid substrates.

**Productivity Software** consists of a complete software suite that enables efficient and automated end-to-end business and production workflows for the print and packaging industry. This *Productivity Suite* also provides tools to enable revenue growth, efficient scheduling, and optimization of processes, equipment, and personnel. Customers are provided the financial and technical flexibility to deploy locally within their business or to be hosted in the cloud. The Productivity Suite addresses all segments of the print industry and consists of the: (i) *Packaging Suite*, with Radius at its core, for tag & label, cartons, and flexible packaging businesses; (ii) *Corrugated Packaging Suite*, with CTI at its core, for corrugated packaging businesses, including corrugated control capability using EFI Escada; (iii) *Enterprise Commercial Print Suite*, with Monarch at its core, for enterprise print businesses; (iv) *Publication Print Suite*, with Monarch or Technique at its core, for publication print businesses; (v) *Midmarket Print Suite*, with Pace at its core, for medium size print businesses; (vi) *Quick Print Suite*, with PrintSmith Vision and essential capabilities of Digital StoreFront at its core, for small printers and in-plant sites; and (vii) *Value Added Products*, available with the suite and standalone, such as web-to-print, e-commerce, cross media marketing, warehousing, fulfillment, shop floor data collection, and shipping to reduce costs, increase profits, and offer new products and services to their existing and future customers. We also market Optitex computer-aided fashion design (“fashion CAD”) software, which facilitates fast fashion and increased efficiency in the textile and fashion industries.

**Fiery** consists of Fiery and FreeFlow Print Server (“FFPS”), which was acquired from Xerox Corporation (“Xerox”), that transform digital copiers and printers into high performance networked printing devices for the office, commercial and industrial printing markets. This operating segment is comprised of (i) stand-alone DFEs connected to digital printers, copiers, and other peripheral devices, (ii) embedded DFEs and design-licensed solutions used in digital copiers and multi-functional devices, (iii) optional software integrated into our DFE solutions such as Fiery Central, and Graphics Arts Package, (iv) Fiery Self Serve, our self-service and payment solution, and (v) stand-alone software-based solutions such as our proofing, textile, and scanning solutions.

Operating income is not reported by operating segment because operating expenses include significant shared expenses and other costs that are managed outside of the operating segments. Such operating expenses include various corporate expenses such as stock-based compensation, corporate sales and marketing, research and development, amortization of identified intangibles, various non-recurring charges, and other separately managed general and administrative expenses.

Revenue and operating segment profit (i.e., gross profit), excluding stock-based compensation expense, during the three months ended March 31, 2018 and 2017 is summarized as follows (in thousands):

	Three months ended	
	March 31,	
	2018	2017
<b>Industrial Inkjet</b>		
Revenue	\$142,209	\$123,263
Gross profit	49,707	49,070
Gross profit percentages	35.0%	39.8%
<b>Productivity Software</b>		
Revenue	\$ 43,775	\$ 35,058
Gross profit	31,413	25,596
Gross profit percentages	71.8%	73.0%
<b>Fiery</b>		
Revenue	\$ 53,882	\$ 70,370
Gross profit	38,755	49,698
Gross profit percentages	71.9%	70.6%

Operating segment profit (i.e. gross profit) is reconciled to our Condensed Consolidated Statements of Operations during the periods presented below as follows (in thousands):

	Three months ended March 31,	
	2018	2017
Segment gross profit	\$ 119,875	\$ 124,364
Stock-based compensation expense	(768)	(834)
Gross profit	\$ 119,107	\$ 123,530

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Tangible and intangible assets, net of liabilities, are summarized by operating segment as follows (in thousands):

	Industrial Inkjet	Productivity Software	Fiery	Corporate and Unallocated Net Assets	Total
<b>March 31, 2018</b>					
Goodwill	\$156,200	\$176,284	\$ 74,392	\$ —	\$406,876
Identified intangible assets, net	60,611	32,751	18,450	—	111,812
Tangible assets, net of liabilities	231,795	(32,018)	23,819	39,358	262,954
Net tangible and intangible assets	<u>\$448,606</u>	<u>\$177,017</u>	<u>\$116,661</u>	<u>\$ 39,358</u>	<u>\$781,642</u>
<b>December 31, 2017</b>					
Goodwill	\$154,373	\$174,644	\$ 74,261	\$ —	\$403,278
Identified intangible assets, net	66,547	36,379	20,082	—	123,008
Tangible assets, net of liabilities	221,933	(27,755)	11,286	49,561	255,025
Net tangible and intangible assets	<u>\$442,853</u>	<u>\$183,268</u>	<u>\$105,629</u>	<u>\$ 49,561</u>	<u>\$781,311</u>

Corporate and unallocated assets and liabilities consist of cash and cash equivalents, short-term investments, restricted cash equivalents, corporate headquarters facility, convertible senior notes, imputed financing obligation related to build-to-suit lease, income taxes receivable, and income taxes payable.

### Geographic Regions

Our revenue originates in the U.S., China, the Netherlands, Germany, Italy, France, the U.K., Spain, Israel, Brazil, and Australia. We report revenue by geographic region based on ship-to destination. Shipments to some of our significant printer manufacturer/distributor customers are made to centralized purchasing and manufacturing locations, which in turn sell through to other locations. As a result of these factors, we believe that sales to certain geographic locations might be higher or lower, as the ultimate destinations are difficult to ascertain.

Our revenue by ship-to destination during the periods presented below was as follows (in thousands):

	Three months ended March 31,	
	2018	2017
Americas	\$ 117,385	\$ 109,895
Europe, Middle East, and Africa (“EMEA”)	88,175	88,033
Asia Pacific (“APAC”)	34,306	30,763
Total revenue	<u>\$ 239,866</u>	<u>\$ 228,691</u>

### Note 10. Derivatives and Hedging

We are exposed to market risk and foreign currency exchange risk from changes in foreign currency exchange rates, which could affect operating results, financial position, and cash flows. We manage our exposure to these risks through our regular operating and financing activities and, when appropriate, through use of derivative financial instruments. These derivative financial instruments are used to hedge monetary assets and liabilities, intercompany balances, trade receivables, anticipated cash flows, and to reduce earnings and cash flow volatility resulting from shifts in foreign currency exchange rates. Our objective is to offset gains and losses resulting from these exposures with losses and gains on the derivative contracts used to hedge them, thereby reducing volatility of earnings or protecting fair values of assets and liabilities. We do not have any leveraged derivatives, nor do we use derivative contracts for speculative purposes. ASC 815, Derivatives and Hedging, requires the fair value of all derivative instruments, including those embedded in other contracts, to be recorded as assets or liabilities in our Condensed Consolidated Balance Sheet. The related cash flow impacts of our derivative contracts are reflected as cash flows from operating activities.

Our exposures are primarily related to non-U.S. dollar-denominated revenue in Europe, the U.K., Latin America, China, Israel, and Australia, and to non-U.S. dollar-denominated operating expenses in Europe, India, the U.K., China, Israel, Brazil, and Australia. From time to time we have hedged our operating expense cash flow exposure in Indian rupees. We hedge balance sheet remeasurement exposure associated with British pound sterling, Canadian dollar, Chinese renminbi, Brazilian real, Israeli shekel, Japanese yen, Chinese renminbi, and Euro-denominated intercompany balances; Brazilian real, British pound sterling, Australian dollar, Israeli shekel, and Euro-denominated trade receivables; and British pound sterling, Israeli shekel, Canadian dollar, and other Euro-denominated net monetary assets.

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By their nature, derivative instruments involve, to varying degrees, elements of market and credit risk. The market risk associated with these instruments resulting from currency exchange movement is expected to offset the market risk of the underlying transactions, assets, and liabilities being hedged (e.g. operating expenses; the collection of trade receivables denominated in currencies other than their respective reporting entity's functional currency, and the settlement of intercompany balances denominated in currencies other than their functional currency). Under our master netting agreements with our foreign currency derivative counterparties, we are allowed to net transactions of the same currency with a single net amount payable by one party to the other. The derivatives held by us are not subject to any credit contingent features negotiated with these counterparties. We are not required to pledge cash collateral related to these foreign currency derivative contracts. We do not believe there is significant risk of loss from non-performance by the counterparty associated with these instruments because, by policy, we deal with counterparties having a minimum investment grade or better credit rating. Credit risk is managed through the continuous monitoring of exposures to such counterparties.

### *Cash Flow Hedges*

We did not have any foreign currency derivative contracts designated as a cash flow hedge as of March 31, 2018. Our foreign currency derivative contracts designated as cash flow hedges for our Indian rupee operating expense were in the notional amounts of \$3.9 million as of December 31, 2017. The fair value of the net assets (liabilities) related to these cash flow hedges are not material. The changes in fair value of these contracts are reported as a component of OCI and reclassified for operating expense in the periods of payment of the hedged operating expenses. The amount of ineffectiveness that was recorded in the Condensed Consolidated Statements of Operations for these designated cash flow hedges was immaterial. All components of each derivative's gain or loss were included in the assessment of hedge effectiveness.

### *Balance Sheet Hedges*

Forward contracts not designated for hedge accounting treatment with notional amounts of \$243.5 and \$235.5 million are used to hedge foreign currency balance sheet exposures at March 31, 2018 and December 31, 2017, respectively. They are not designated for hedge accounting treatment since there is a natural offset for the remeasurement of the underlying foreign currency denominated asset or liability. We recognize changes in the fair value of non-designated derivative instruments in earnings in the period of change. Gains and losses on foreign currency forward contracts used to hedge balance sheet exposures are recognized in interest income and other income, net of expenses, in the same period as the remeasurement gain or loss of the related foreign currency denominated assets and liabilities. Our forward contracts not designated for hedge accounting treatment consisted of hedges of Australian dollar, British pound sterling, Brazilian real, Canadian dollar, Chinese renminbi, Euro, Indian rupee, Israeli shekel and Japanese yen.

These balance sheet hedges cover currency exposures in the following line items in the notional amounts indicated (in thousands):

<u>Balance sheet categories</u>	<u>March 31, 2018</u>	<u>December 31, 2017</u>
Accounts Receivable	\$ 52,130	\$ 44,427
Other assets and liabilities, net	34,109	46,550
Intercompany balances	157,247	144,477
Total	<u>\$243,486</u>	<u>\$ 235,454</u>

### **Note 11. Restructuring and Other**

During the three months ended March 31, 2018 and 2017, we continue to analyze our cost structure and re-align our cost structure following our business acquisitions. These charges primarily relate to integrating recently acquired businesses, consolidating facilities, eliminating redundancies, and lowering our operating expense run rate. Restructuring and other consists primarily of restructuring, severance, short-term retention costs, facility downsizing and relocation, and acquisition integration expenses. Our restructuring and other plans are accounted for in accordance with ASC 420, Exit or Disposal Cost Obligations, ASC 712, Compensation – Non-Retirement Postemployment Benefits, and ASC 820, Fair Value Measurements, and disclosures.

Restructuring and other costs were \$4.7 and \$0.9 million during the three months ended March 31, 2018 and 2017, respectively. Restructuring and other costs include severance charges of \$3.0 and \$0.4 million related to reductions in head count of 55 and 18 during the three months ended March 31, 2018 and 2017, respectively. Severance costs include severance payments, related employee benefits, outplacement fees, recruiting, and employee relocation costs.

Facilities relocation and downsizing expenses were \$0.5 and \$0.1 million during the three months ended March 31, 2018 and 2017, respectively, primarily related to the relocation of certain manufacturing and administrative locations due to reduced space requirements. Integration expenses of \$1.1 and \$0.5 million during the three months ended March 31, 2018 and 2017, respectively, were required to integrate our business acquisitions.

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Restructuring and other reserve activities during the periods presented below are summarized as follows (in thousands):

	Three months ended March 31,	
	2018	2017
Beginning reserve balance	\$ 2,452	\$ 1,824
Restructuring charges	2,916	285
Other charges	1,738	633
Non-cash restructuring and other	(173)	(63)
Payments	(3,102)	(684)
Ending reserve balance	<u>\$ 3,831</u>	<u>\$ 1,995</u>

### Note 12. Stock-based Compensation

We account for stock-based payment awards in accordance with ASC 718, Stock Compensation, which requires the measurement and recognition of compensation expense for all equity awards granted to our employees and directors, including RSUs, ESPP purchase rights, and employee stock options related to all stock-based compensation plans based on the fair value of such awards on the date of grant. We amortize stock-based compensation cost on a graded vesting basis over the vesting period reduced by actual forfeitures, after assessing the probability of achieving the requisite performance criteria with respect to performance-based awards. Stock-based compensation cost is recognized over the requisite service period for each separately vesting tranche of the award as though the award were, in substance, multiple awards.

Stock-based compensation expense related to stock options, ESPP purchase rights, and RSUs during the periods presented below is summarized as follows (in thousands):

	Three months ended March 31,	
	2018	2017
Stock-based compensation expense by type of awards		
RSUs	\$ 5,324	\$ 9,237
ESPP purchase rights	<u>1,446</u>	<u>1,043</u>
Total stock-based compensation	6,770	10,280
Income tax benefit	(858)	(2,873)
Stock-based compensation expense, net of tax	<u>\$ 5,912</u>	<u>\$ 7,407</u>

#### Valuation Assumptions for Stock Options and ESPP Purchase Rights

We use the Black-Scholes-Merton (“BSM”) option pricing model to value stock-based compensation for all equity awards, except market-based awards, which are valued using the Monte Carlo valuation model. We value RSUs at the market price on the date of grant.

Stock options were not granted during the three months ended March 31, 2018 and 2017. The estimated weighted average fair value per share of ESPP purchase rights issued and the underlying weighted average assumptions for the periods presented below are as follows:

	Three months ended March 31,	
	2018	2017
Weighted average fair value per share	\$ 9.03	\$ 12.03
Expected volatility	59% - 107%	24% - 28%
Risk-free interest rate	1.6% - 2.2%	0.7% - 1.2%
Expected term (in years)	0.5 - 2.0	0.5 - 2.0

As of March 31, 2018, 150,000 shares underlying stock options are outstanding and exercisable. They are time-based options with an aggregate intrinsic value of \$1.8 million, weighted average exercise price of \$15.43 per share, and the remaining contractual term of 1.03 years. Aggregate intrinsic value for stock options represents the difference between the closing price per share of our common stock on the last trading day of the fiscal period and the option exercise price multiplied by the number of in-the-money stock options outstanding, vested and expected to vest, and exercisable at March 31, 2018.

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*Non-vested RSUs*

Non-vested RSUs were awarded to employees under our equity incentive plans. Non-vested RSUs do not have the voting rights of common stock and the shares underlying non-vested RSUs are not considered issued and outstanding. Non-vested RSUs generally vest over a service period of one to four years. The compensation expense incurred for these service-based awards is based on the closing market price of our stock on the date of grant and is amortized on a graded vesting basis over the requisite service period.

Non-vested RSUs during the three months ended March 31, 2018 are summarized below (shares in thousands):

	Time-based		Performance-based		Market-based		Total	
	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value
<b>Non-vested at January 1, 2018</b>	1,048	\$ 35.76	1,209	\$ 42.18	23	\$ 35.15	2,280	\$ 39.16
Granted	138	28.84	363	28.59	—	—	501	28.66
Vested	(27)	35.75	(12)	44.08	—	—	(39)	38.28
Forfeited	(44)	35.68	(562)	45.72	—	—	(606)	44.94
<b>Non-vested at March 31, 2018</b>	<b>1,115</b>	<b>34.90</b>	<b>998</b>	<b>35.23</b>	<b>23</b>	<b>35.15</b>	<b>2,136</b>	<b>35.07</b>

*Vested RSUs*

The grant date fair value of RSUs vested during the three months ended March 31, 2018 was \$1.5 million. The aggregate intrinsic value of RSUs vested and expected to vest at March 31, 2018 was \$38.3 million and the remaining weighted average vesting period was 1.22 years. Aggregate intrinsic value for RSUs vested and expected to vest represents the closing price per share of our common stock on the last trading day of the fiscal period, multiplied by the number of RSUs vested and expected to vest as of March 31, 2018. RSUs expected to vest represent time-based RSUs unvested and outstanding at March 31, 2018, and performance-based RSUs for which the requisite service period has not been rendered, but are expected to vest based on the achievement of performance conditions. Performance-based RSUs that vested based on annual financial results are expensed in the period that the performance and related service criteria were met.

*Valuation Assumptions for Performance-based and Market-based RSUs*

Performance-based stock options, market-based RSUs, and market-based stock options were not granted during the three months ended March 31, 2018. We use the BSM option pricing model to value performance-based RSUs. The weighted average grant date fair value per share of performance-based RSUs granted and the assumptions used to estimate grant date fair value during the periods presented below are as follows:

	Short-term	Long-term
<b>Three months ended March 31, 2018 Grants</b>		
Grant date fair value per share	\$ 28.59	\$ —
Service period (years)	1.0	N/A
<b>Three months ended March 31, 2017 Grants</b>		
Grant date fair value per share	\$ 47.28	\$ 45.89
Service period (years)	1.0	2.0 - 3.0

Our performance-based RSUs generally vest when specified performance criteria are met based on bookings, revenue, cash provided by operating activities, non-GAAP operating income, non-GAAP earnings per share, revenue growth compared to market comparables, non-GAAP earnings per share growth compared to cash flow from operating activities growth, or other targets during the service period; otherwise, they are forfeited. Non-GAAP operating income is defined as operating income determined in accordance with GAAP, adjusted to remove the impact of certain expenses as defined in Unaudited Non-GAAP Financial Information. Non-GAAP earnings per share is defined as net income determined in accordance with GAAP, adjusted to remove the impact of certain expenses, and the related tax effects, divided by the weighted average number of common shares and dilutive potential common shares outstanding during the period as more fully defined in Note 2 – Earnings Per Share.

The grant date fair value per share determined in accordance with the BSM valuation model is being amortized over the service period of the performance-based awards. The probability of achieving the awards was determined based on review of the actual results achieved thus far by each business unit compared with the operating plan during the pertinent service period as well as the overall strength of the business unit. Stock-based compensation expense was adjusted based on this probability assessment. As actual results are achieved during the service period, the probability assessment is updated and stock-based compensation expense adjusted accordingly.

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Market-based awards that were granted in prior periods vest when our average closing stock price exceeds defined multiples of the closing stock price for 90 consecutive trading days. If these multiples were not achieved by the expiration date, the awards are forfeited. The grant date fair value is being amortized over the average derived service period of the awards. The average derived service period and total fair value were determined using a Monte Carlo valuation model based on our assumptions, which include a risk-free interest rate and implied volatility.

### **Note 13. Common Stock Repurchase Programs**

On November 9, 2015, the board of directors approved the repurchase of \$150 million of outstanding common stock commencing January 1, 2016. On September 11, 2017, the board of directors approved the repurchase of an additional \$125 million for our share repurchase program commencing September 11, 2017. At that time, \$28.8 million remained available for repurchase under the 2015 authorization. The 2017 authorization thereby increased the repurchase authorization to \$153.8 million of our common stock. This authorization expires December 31, 2018. Under this publicly announced plan, we repurchased 0.6 and 0.4 million shares for an aggregate purchase price of \$17.4 and \$17.5 million during the three months ended March 31, 2018 and 2017, respectively. As of March 31, 2018, \$92.0 million remained available for repurchase under this authorization.

Our employees have the option to surrender shares of common stock to satisfy their tax withholding obligations that arise on the vesting of RSUs. In connection with stock option exercises, certain employees can surrender shares to satisfy the exercise price of certain stock options and any tax withholding obligations incurred in connection with such exercises. Employees surrendered less than 0.1 million and 0.1 million shares for an aggregate purchase price of \$0.2 and \$5.0 million during the three months ended March 31, 2018 and 2017, respectively.

These repurchased shares reduce shares outstanding and are recorded as treasury stock under the cost method thereby reducing stockholders' equity by the cost of the repurchased shares. Our repurchase program is limited by SEC regulations and is subject to compliance with our insider trading policy.

### **Note 14. Accounts Receivable**

#### *Financing Receivables*

ASC 310, Receivables, requires disclosure regarding the credit quality of our financing receivables and allowance for credit losses including disclosure of credit quality indicators, past due information, and modifications of our financing receivables. Our financing receivables of \$38.0 and \$28.7 million consisting of \$23.7 and \$16.6 million of sales-type lease receivables, included within other current assets and other assets at March 31, 2018 and December 31, 2017, respectively, and \$14.2 and \$12.1 million of trade receivables having an original contractual maturity in excess of one year, included within accounts receivable, net of allowance, at March 31, 2018 and December 31, 2017, respectively. The trade receivables of \$14.2 and \$12.1 million having an original total contractual maturity in excess of one year at March 31, 2018 and December 31, 2017, include \$4.9 and \$4.4 million, respectively, which are scheduled to be received in less than one year. The credit quality of financing receivables is evaluated on the same basis as trade receivables. We do not have material past due financing receivables.

#### *Accounts Receivable Sales Arrangements*

In accordance with ASC 860-20, Transfers and Servicing, trade receivables are derecognized from our Condensed Consolidated Balance Sheet when sold to third parties upon determining that such receivables are presumptively beyond the reach of creditors in a bankruptcy proceeding. Any recourse obligation is measured using market data from similar transactions and the servicing liability is determined based on the fair value that a third party would charge to service these receivables. These liabilities were determined to not be material at March 31, 2018 and December 31, 2017.

We have facilities in the U.S. and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables with recourse. Trade receivables sold with recourse are generally short-term receivables with payment due dates of less than 10 days from the date of sale, which are subject to a servicing obligation. Trade receivables sold under these facilities were \$3.2 and \$21.4 million during the three months ended March 31, 2018, and the year ended December 31, 2017, which approximates the cash received.

We have facilities in Spain and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables without recourse. Trade receivables sold without recourse are generally short-term receivables with payment due dates of less than one year, which are secured by international letters of credit. Trade receivables sold under these facilities were \$1.3 and \$5.9 million during the three months ended March 31, 2018, and the year ended December 31, 2017, which approximates the cash received.

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We report collections from the sale of trade receivables to third parties as operating cash flows in the Condensed Consolidated Statements of Cash Flows.

**Note 15. License Agreement**

On November 1, 2017 (“Effective Date”), we entered into an agreement with Xeikon (the Agreement), which is a division of the Flint Group headquartered in Luxembourg to license the rights to the manufacturing, technology, marketing, and support of the Jetrion business. Pursuant to the Agreement, we provided Xeikon access to the Jetrion customer list and enabled Xeikon to assume the relationship with the third-party outsourcing company that manufactured Jetrion printers for us and resell the printers to our current customer base. Xeikon will purchase UV label ink exclusively from us and resell to both our current customer base as well as new Xeikon inkjet customers. Per the terms of the Agreement, we agreed to cease sales of Jetrion products for four years after the Effective Date. We received cash consideration of \$2.0 million during 2017, and will receive annual volume-based royalty payments based on Xeikon’s ink purchases from us through October 31, 2021.

Volume-based royalty payments from Xeikon’s ink purchases are recognized as revenue ratably over four years. For the three months ended March 31, 2018, we recognized \$0.1 million of revenue in our Condensed Consolidated Statements of Operations from the Agreement.



## **Item 2: Management’s Discussion and Analysis of Financial Condition and Results of Operations**

### **Forward-looking Statements**

*This Quarterly Report on Form 10-Q (“Report”), including “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements regarding future events and the future results of the Company that are based on current expectations, estimates, forecasts, and projections about the industry in which the Company operates and the beliefs and assumptions of the management of the Company. Words such as “address,” “anticipate,” “believe,” “consider,” “continue,” “develop,” “estimate,” “expect,” “further,” “goal,” “intend,” “may,” “plan,” “potential,” “project,” “seek,” “should,” “target,” “will,” variations of such words, and similar expressions are intended to identify such forward-looking statements. Such statements reflect the current views of the Company and its management with respect to future events and are subject to certain risks, uncertainties, and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, the Company’s actual results, performance, or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Report under the section entitled “Risk Factors” in Item 1A of Part II of this report and Item 1A of Part I of our 2017 Form 10-K and elsewhere and in other reports the Company files with the SEC. The following discussion should be read in conjunction with our 2017 Form 10-K and the condensed consolidated financial statements and notes thereto included elsewhere in this Report. The Company assumes no obligation to revise or update these forward-looking statements to reflect actual results, events, or changes in factors or assumptions affecting such forward-looking statements*

### **Business Overview**

We are a world leader in customer-centric digital printing innovation focused on the transformation of the printing, packaging, ceramic tile decoration, and textile industries from the use of traditional analog based printing to digital on-demand printing.

Our products include industrial super-wide and wide format display graphics, corrugated packaging and display, textile, and ceramic tile decoration digital inkjet printers that utilize our digital ink, industrial digital inkjet printer parts, and professional services; print production workflow, web-to-print, cross-media marketing, fashion design, and business process automation solutions; and color printing DFEs creating an on-demand digital printing ecosystem. Our ink includes digital UV curable, LED curable, ceramic, water-based, and thermoforming and specialty ink, as well as a variety of textile ink including dye sublimation, pigmented, reactive dye, acid dye, pure disperse dye, water-based dispersed printing ink, and coatings. Our award-winning business process automation solutions are integrated from creation to print and are vertically integrated with our industrial digital inkjet printers and products produced by the leading production digital color page printer manufacturers that are driven by our Fiery DFEs.

Our product portfolio includes industrial super-wide and wide format digital inkjet products (“Industrial Inkjet”) including VUTEk display graphics super-wide and wide format, Nozomi corrugated packaging, Reggiani textile, Cretaprint ceramic tile decoration and building material industrial digital inkjet printers and ink; print production workflow, web-to-print, cross-media marketing, Optitex textile two-dimensional (“2D”) and three-dimensional (“3D”) fashion computer-aided design applications, and business process automation software (“Productivity Software”), which provides corporate printing, corrugated packaging, publishing, and mailing and fulfillment solutions for the printing and packaging industry; and Fiery DFEs (“Fiery”). Our integrated solutions and award-winning technologies are designed to automate print and business processes, streamline workflow, provide profitable value-added services, and produce accurate digital output.

### **Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments, assumptions, and estimates that affect the amounts reported. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably possible could materially impact the financial statements. Management believes there have been no significant changes during the three months ended March 31, 2018 to the items that we disclosed as our critical accounting policies and estimates in Management’s Discussion and Analysis of Financial Condition and Results of Operations in our 2017 Form 10-K, with the exception of the following:

#### *Revenue Recognition*

Effective January 1, 2018, we adopted ASC 606 and ASC 340-40 using the modified retrospective method applied to those contracts that were not completed as of January 1, 2018. As a result of the adoption, we use significant judgments in applying the new revenue standards as further outlined in Notes 1 and 4 to Condensed Consolidated Financial Statements.

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**Recent Accounting Pronouncements**

See Note 1 – Basis of Presentation and Significant Accounting Policies of Notes to Condensed Consolidated Financial Statements for a full description of recent accounting pronouncements including the respective expected dates of adoption.

**Results of Operations**

*Overview*

	Three months ended March 31,					
	2018		2017		Change	
		% of Revenue		% of Revenue	\$	%
Revenue	\$239,866	100.0%	\$228,691	100.0%	\$ 11,175	5%
Cost of revenue	<u>120,759</u>	50.3	<u>105,161</u>	46.0	<u>15,598</u>	15
Gross profit	119,107	49.7	123,530	54.0	(4,423)	(4)
Research and development	38,279	16.0	39,627	17.3	(1,348)	(3)
Sales and marketing	46,680	19.5	43,035	18.8	3,645	8
General and administrative	19,421	8.1	21,029	9.2	(1,608)	(8)
Restructuring and other	4,654	1.9	918	0.5	3,736	407
Amortization of identified intangibles	<u>12,138</u>	5.1	<u>10,778</u>	4.7	<u>1,360</u>	13
Total operating expenses	<u>121,172</u>	50.6	<u>115,387</u>	50.5	<u>5,785</u>	5
Income (loss) from operations	(2,065)	(0.9)	8,143	3.6	(10,208)	*
Interest expense	(4,954)	(2.0)	(4,660)	(2.0)	(294)	6
Interest income and other income, net of expenses	<u>1,289</u>	0.5	<u>287</u>	0.1	<u>1,002</u>	349
Income (loss) before income taxes	(5,730)	(2.4)	3,770	1.7	(9,500)	*
Benefit from income taxes	<u>2,135</u>	0.9	<u>1,017</u>	0.4	<u>1,118</u>	110
Net income (loss)	<u>\$ (3,595)</u>	(1.5)%	<u>\$ 4,787</u>	2.1%	<u>\$ (8,382)</u>	*

\* Percentages not meaningful.

Key financial results during the three months ended March 31, 2018 were as follows:

- Our consolidated revenue increased by \$11.2 million, or 5%, during the three months ended March 31, 2018, compared to the same period in the prior year. The increase was driven by an \$18.9 million increase in Industrial Inkjet revenue and an \$8.7 million increase in Productivity Software revenue, partially offset by a \$16.5 million decrease in Fiery revenue for the three months ended March 31, 2018, compared with the same period in the prior year.
- Gross profit decreased by \$4.4 million or 4% during the three months ended March 31, 2018, compared to the same period last year. Gross profit percentage declined to 49.7% from 54.0% during the three months ended March 31, 2018 and 2017, respectively. These reductions were primarily due to the reduced contribution of Fiery to our overall revenue, and reduced Industrial Inkjet gross margins attributable to the ramp-up of production on new products.
- Operating expenses increased by \$5.8 million or 5% during the three months ended March 31, 2018 compared to the same period last year. The increase in operating expenses was primarily due to increases in restructuring and other expenses of \$3.7 million, sales and marketing expenses of \$3.6 million and amortization of intangible assets of \$1.4 million, partially offset by decreases in general and administrative expenses of \$1.6 million and research and development expenses of \$1.3 million.
- Interest expense and interest income and other income, net of expenses decreased by \$0.7 million on a combined basis in the three months ended March 31, 2018 compared to the same period last year, primarily due to foreign currency gains of \$0.3 million and imputed interest income of \$0.2 million recognized on revenue contracts following the adoption of the new revenue recognition guidance.
- Benefit from income taxes increased by \$1.1 million during the three months ended March 31, 2018, compared to the same period last year primarily due to lower pre-tax income (loss).

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### *Revenue*

We classify our revenue, gross profit, assets, and liabilities in accordance with our three operating segments, as described in Note 9 – Segment Information and Geographic Data in our Notes to Condensed Consolidated Financial Statements; Industrial Inkjet, Productivity Software, and Fiery.

Ex-Currency. To better understand trends in our business, we believe it is helpful to adjust our Condensed Consolidated Statements of Operations to exclude the impact of year-over-year changes in the translation of foreign currencies into U.S. dollars. This is a non-GAAP measure that is calculated by adjusting revenue, gross profit, and operating expenses by using historical exchange rates in effect during the comparable prior period and removing the balance sheet currency remeasurement impact from interest income and other income, net of expenses, including removal of any hedging gains and losses. We refer to these adjustments as “ex-currency.” The year-over-year currency impact can be determined as the difference between year-over-year actual growth rates and year-over-year ex-currency growth rates.

Management believes the ex-currency measures provide investors with an additional perspective on year-over-year financial trends and enables investors to analyze our operating results in the same way management does. A reconciliation of the ex-currency adjustments to GAAP results for the three months ended March 31, 2018 and 2017 and an explanation of how management uses non-GAAP financial information to evaluate its business, the substance behind management’s decision to use this non-GAAP financial information, the material limitations associated with the use of non-GAAP financial information, the manner in which management compensates for those limitations, and the substantive reasons management believes that this non-GAAP financial information provides useful information to investors is included under “Non-GAAP Financial Information” below.

### Revenue by Operating Segment

Our revenue by operating segment during the periods presented below was as follows (in thousands):

	Three months ended March 31,				Change	
	2018	% of total	2017	% of total	\$	%
Industrial Inkjet	\$142,209	59%	\$123,263	54%	\$ 18,946	15%
Productivity Software	43,775	18	35,058	15	8,717	25
Fiery	53,882	23	70,370	31	(16,488)	(23)
Total revenue	<u>\$239,866</u>	<u>100%</u>	<u>\$228,691</u>	<u>100%</u>	<u>\$ 11,175</u>	<u>5%</u>

Our consolidated revenue increased by \$11.2 million or 5% (flat ex-currency) during the three months ended March 31, 2018 compared to the same period in 2017, primarily due to increased Industrial Inkjet and Productivity Software revenue, partially offset by decreased Fiery revenue. In addition, adoption of the new revenue recognition guidance increased reported revenue by \$1.5 million in the current quarter, primarily in the Productivity Software segment, compared to the previous revenue recognition guidance.

### *Industrial Inkjet*

Industrial Inkjet revenue increased by \$18.9 million, or 15% (8% ex-currency), during the three months ended March 31, 2018 compared with the same period in 2017. Industrial Inkjet revenue increased primarily due to:

- Revenue from our Nozomi single-pass industrial digital inkjet platform launched in the third quarter of 2017,
- increased ink and supplies revenue due to the increase in our installed printer base and the high utilization that our industrial digital inkjet printers are experiencing in the field, and
- increased revenue from parts.

The Nozomi single-pass industrial digital inkjet platform was launched in the third quarter of 2017, for the corrugated, paper packaging, display printing, and other related markets. We have invested significantly in the research and development, sales and marketing, and manufacturing processes required to successfully launch this product. While we have sold a limited number of printers, we are unable to predict the actual level of demand for this product because Nozomi is a new product. If this product is not successful in the market, then our consolidated financial position and results of operations could be materially impacted.

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### **Productivity Software**

Productivity Software revenue increased by \$8.7 million, or 25% (21% ex-currency), during the three months ended March 31, 2018 compared with the same period in 2017. Productivity software revenue increased primarily due to:

- increased license revenue,
- sales from Escada, which we acquired in the fourth quarter of 2017,
- increased maintenance revenue, and
- the impact from adoption of the new revenue recognition guidance which increased revenue in the first quarter of 2018, compared to the previous revenue recognition guidance.

### **Fiery**

Fiery revenue decreased by \$16.5 million, or 23% (24% ex-currency) during the three months ended March 31, 2018 compared with the same period in 2017. Although end customer and reseller preference for Fiery products drives demand, most Fiery revenue relies on printer manufacturers to design, develop, and integrate Fiery technology into their print engines. The leading printer manufacturers experienced reduced demand for Fiery controllers and software options, which was partially offset by an increase in revenue from parts.

### **Revenue by Geographic Area**

Shipments to some of our significant printer manufacturer customers are made to centralized purchasing and manufacturing locations, which in turn ship to other locations, making it difficult to obtain completely accurate geographical shipment data. Accordingly, we believe that export sales of our products into each region may differ from what is reported.

Our revenue by geographic area during the periods presented below was as follows (in thousands):

	Three months ended March 31,				Change	
	2018	% of total	2017	% of total	\$	%
Americas	\$117,385	49%	\$109,895	48%	\$ 7,490	7%
EMEA	88,175	37	88,033	39	142	0
APAC	34,306	14	30,763	13	3,543	12
Total revenue	<u>\$239,866</u>	<u>100%</u>	<u>\$228,691</u>	<u>100%</u>	<u>\$11,175</u>	<u>5%</u>

**Americas.** Revenue increased by \$7.5 million, or 7% (6% ex-currency), during the three months ended March 31, 2018 compared with the same period in 2017, due to strong growth in Industrial Inkjet and Productivity Software revenue, partially offset by lower Fiery revenue. The impact from adoption of the new revenue recognition guidance increased revenue in the first quarter of 2018, compared to the previous revenue recognition guidance.

**EMEA.** Revenue increased by \$0.1 million, or less than 1% (decreased by 9% ex-currency), during the three months ended March 31, 2018 compared with the same period in 2017, primarily due to increased Industrial Inkjet revenue and growth in Productivity Software revenue, partially offset by decreased Fiery revenue. The impact from adoption of the new revenue recognition guidance increased revenue in the first quarter of 2018, compared to the previous revenue recognition guidance.

**APAC.** Revenue increased by \$3.5 million, or 12% (5% ex-currency), during the three months ended March 31, 2018 compared with the same period in 2017, primarily due to strong growth in Industrial Inkjet and Productivity Software revenue, partially offset by decreased Fiery revenue.

### **Revenue Concentration**

A substantial portion of our revenue has been attributable to sales of products through the leading printer manufacturers and independent distributor channels. We have a direct relationship with several leading printer manufacturers and work closely to design, develop, and integrate Fiery technology into their print engines. A significant portion of our revenue is, and has been, generated by sales of our Fiery DFE products to a relatively small number of leading printer manufacturers. During the three months ended March 31, 2018 and 2017, Xerox provided less than 10% and 10% of our consolidated revenue, respectively. We expect that if we continue to increase our revenue in the Industrial Inkjet and Productivity Software operating segments in the future, the percentage of our revenue from the leading printer manufacturer customers will decrease.

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[Table of Contents](#)*Gross Profit*

Gross profit by operating segment, excluding stock-based compensation, during the periods presented below was as follows (in thousands):

	Three months ended March 31,	
	2018	2017
<b>Industrial Inkjet</b>		
Revenue	\$ 142,209	\$ 123,263
Gross profit	49,707	49,070
Gross profit percentages	35.0%	39.8%
<b>Productivity Software</b>		
Revenue	\$ 43,775	\$ 35,058
Gross profit	31,413	25,596
Gross profit percentages	71.8%	73.0%
<b>Fiery</b>		
Revenue	\$ 53,882	\$ 70,370
Gross profit	38,755	49,698
Gross profit percentages	71.9%	70.6%

A reconciliation of our segment gross profit to our Condensed Consolidated Statements of Operations during the periods presented below was as follows (in thousands):

	Three months ended March 31,	
	2018	2017
Segment gross profit	\$ 119,875	\$ 124,364
Stock-based compensation expense	(768)	(834)
Gross profit	<u>\$ 119,107</u>	<u>\$ 123,530</u>

Our gross profit percentage decreased to 49.7% during the three months ended March 31, 2018 from 54.0% during the same period in 2017. The decreased gross profit percentage was primarily due to the greater proportion of Industrial Inkjet revenues than Productivity Software and Fiery revenues in the first quarter of 2018 compared to the prior year period. The Productivity Software and Fiery segments produce higher average gross profit percentages than our Industrial Inkjet segment. In addition, as more fully explained below, the gross profit percentage in the Industrial Inkjet segment was lower in the three months ended March 31, 2018 than in the comparable prior year period. The impact from adoption of the new revenue recognition guidance increased reported gross profit by \$1.5 million in the current quarter, primarily in the Productivity Software segment, compared to the previous revenue recognition guidance.

*Industrial Inkjet Gross Profit*

The Industrial Inkjet gross profit percentage decreased to 35.0% (33.7% ex-currency) during the three months ended March 31, 2018 from 39.8% during the same period in 2017. Gross profit percentages for industrial digital inkjet printers decreased due to a higher proportion of corrugated printer sales, which are currently at a relatively lower gross profit percentage due to the ramping up of production and sales of our new Nozomi single-pass industrial digital inkjet platform. Partially offsetting the impact of lower printer gross profit percentages were higher gross profit percentages for ink and supplies, and parts and service revenues. The impact from adoption of the new revenue recognition guidance decreased gross profit in the first quarter of 2018, compared to the previous revenue recognition guidance.

*Productivity Software Gross Profit*

The Productivity Software gross profit percentages decreased to 71.8% (72.2% ex-currency) during the three months ended March 31, 2018, from 73.0% during the same period in 2017, primarily due to changes in product mix. Lower gross profit on software service revenue and maintenance was partially offset by increased gross profit on license and subscription revenue, and hardware revenues. In addition, the impact from adoption of the new revenue recognition guidance increased gross profit in the first quarter of 2018 compared to the previous revenue recognition guidance.

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### *Fiery Gross Profit*

The Fiery gross profit percentage increased to 71.9% (also 71.9% ex-currency) during the three months ended March 31, 2018 compared to 70.6% during the same period in 2017.

### *Operating Expenses*

Operating expenses during the periods presented below were as follows (in thousands):

	Three months ended March 31,			
	2018	2017	Change	
			\$	%
Research and development	\$ 38,279	\$ 39,627	\$(1,348)	(3)%
Sales and marketing	46,680	43,035	3,645	8
General and administrative	19,421	21,029	(1,608)	(8)
Restructuring and other	4,654	918	3,736	407
Amortization of identified intangibles	12,138	10,778	1,360	13
Total operating expenses	<u>\$121,172</u>	<u>\$115,387</u>	<u>\$ 5,785</u>	5%

Operating expenses increased by \$5.8 million, or 5% (1% ex-currency) during the three months ended March 31, 2018 compared to the same period in 2017. The increase in operating expenses was primarily due to higher sales and marketing expenses, increased restructuring and other costs, and increased amortization of identified intangibles from recent acquisitions. Partially offsetting these increases were lower research and development and general and administrative expenses.

### Research and Development

Research and development expenses include personnel, consulting, travel, research and development facilities, prototype materials, testing and development equipment, and non-recurring engineering expenses.

Research and development expenses during the three months ended March 31, 2018 were \$38.3 million, or 16.0% of revenue, compared to \$39.6 million, or 17.3% of revenue, during the same period in 2017. The decrease of \$1.3 million, or 3% (6% ex-currency), reflects a reduction in stock-based compensation expense of \$1.2 million primarily due to the timing of new grants and reduced vesting probabilities of certain performance based awards, partially offset by increased ESPP expense due to a price reset compared to the prior year.

We expect that if the U.S. dollar remains volatile against the Indian rupee, Euro, British pound sterling, Israeli shekel, or Brazilian real, research and development expenses reported in U.S. dollars could fluctuate, although we occasionally hedge our operating expense exposure to the Indian rupee, which partially mitigates this risk.

### Sales and Marketing

Sales and marketing expenses include personnel, trade shows, marketing programs and promotional materials, sales commissions, travel and entertainment, depreciation, and worldwide sales office expenses.

Sales and marketing expenses during the three months ended March 31, 2018 were \$46.7 million, or 19.5% of revenue, compared to \$43.0 million, or 18.8% of revenue, during the same period in 2017, representing an increase of \$3.6 million, or 8% (3% ex-currency). Personnel-related expenses increased by \$3.2 million primarily due to increased head count related to our expanded sales efforts around new products, as well as our recent business acquisitions. Trade show and marketing program spending, including consulting and contractor, increased by \$0.9 million. Stock-based compensation expense decreased by \$0.5 million primarily due to timing of new grants and reduced vesting probabilities of certain performance based awards, partially offset by increased ESPP expense due to a price reset compared to the prior year.

Over time, our sales and marketing expenses may increase in absolute terms if revenue increases in future periods, as we continue to actively promote our products and introduce new services and products. We expect that if the U.S. dollar remains volatile against the Euro, British pound sterling, Brazilian real, Israeli shekel, Chinese renminbi, and other currencies, sales and marketing expenses reported in U.S. dollars could fluctuate.

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### General and Administrative

General and administrative expenses consist primarily of human resources, legal, bad debts, litigation, and finance expenses, as well as changes in the fair value of earnout liabilities.

General and administrative expenses during the three months ended March 31, 2018 were \$19.4 million, or 8.1% of revenue, compared to \$21.0 million, or 9.2% of revenue, during the same period in 2017, which is a decrease of \$1.6 million, or 8% (11% ex-currency). The change in fair value of earnout liabilities decreased by \$2.5 million. In the three months ended March 31, 2018, reductions in the estimated earnout liabilities for Generation Digital and Shuttleworth totaling \$1.5 million were partially offset by accretion of \$0.2 million across all earnout liabilities. In the three months ended March 31, 2017, we recognized an increase in the Optitex earnout performance probability and \$0.4 million of earnout interest accretion related to all acquisitions. Stock-based compensation expense decreased by \$1.7 million primarily due to timing of new grants and reduced vesting probabilities of certain performance based awards, partially offset by increased ESPP expense due to a price reset compared to the prior year. These decreases were partially offset by increased personnel-related expenses of \$1.5 million primarily due to head count increases related to our business acquisitions and higher travel expenses, and increased professional fees of \$0.6 million.

We expect that if the U.S. dollar remains volatile against the Euro, British pound sterling, Indian rupee, Israeli shekel, Brazilian real, or other currencies, general and administrative expenses reported in U.S. dollars could fluctuate.

### Stock-based Compensation

We amortize stock-based compensation cost on a graded vesting basis over the vesting period, after assessing the probability of achieving requisite performance criteria with respect to performance-based and market-based awards. Stock-based compensation cost is recognized over the requisite service period for each separately vesting tranche of the award as though the award were, in substance, multiple awards. This results in greater stock-based compensation expense during the initial years of the vesting period.

Stock-based compensation expenses were \$6.8 and \$10.3 million during the three months ended March 31, 2018 and 2017, respectively, a decrease of \$3.5 million. Stock-based compensation expense decreased primarily due to timing of new grants and reduced vesting probabilities of certain performance based awards, partially offset by increased ESPP expenses due to a price reset compared to the prior year.

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### Restructuring and Other

Restructuring and other costs were \$4.7 and \$0.9 million during the three months ended March 31, 2018 and 2017, respectively. Restructuring and other costs include severance charges of \$3.0 and \$0.4 million related to reductions in head count of 55 and 18 during the three months ended March 31, 2018 and 2017, respectively. Severance costs include severance payments, related employee benefits, outplacement fees, recruiting, and employee relocation costs.

Facilities relocation and downsizing expenses were \$0.5 and \$0.1 million during the three months ended March 31, 2018 and 2017, respectively, primarily related to the relocation of certain manufacturing and administrative locations to accommodate decreased space requirements in 2018 and 2017. Integration expenses of \$1.1 and \$0.5 million during the three months ended March 31, 2018 and 2017, respectively, were required to integrate our business acquisitions.

### Amortization of Identified Intangibles

Amortization of identified intangibles during the three months ended March 31, 2018 was \$12.1 million, or 5.1% of revenue, compared to \$10.8 million, or 4.7% of revenue, during the same period in 2017, an increase of \$1.4 million, or 13%. Intangible amortization increased primarily due to amortization of identified intangibles resulting from the Escada, Generation Digital, and FFPS acquisitions, partially offset by decreased amortization due to certain intangible assets from prior year acquisitions becoming fully amortized.

### *Interest Expense*

Interest expense during the three months ended March 31, 2018 was \$5.0 million compared to \$4.7 million during the same period in 2017, an increase of \$0.3 million primarily due to interest accretion related to the FFPS purchase liability and our Notes.

### *Interest Income and Other Income, Net of Expenses*

Interest income and other income, net of expenses, includes interest income on our cash equivalents and short-term investments, gains and losses from sales of our cash equivalents and short-term investments, imputed interest on contracts with a significant financing component, and net foreign currency exchange gains and losses.

Interest income and other income, net, increased to \$1.3 million during the three months ended March 31, 2018, from \$0.3 million during the same period in 2017, primarily due to increased investment income resulting from increased market interest rates and increased foreign currency exchange gains.

### *Income Before Income Taxes*

The geographic mix of income before income taxes during the periods presented below are as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
U.S.	\$ (12,297)	\$ (3,247)
Foreign	6,567	7,017
Total	<u>\$ (5,730)</u>	<u>\$ 3,770</u>

During the three months ended March 31, 2018, pretax loss of \$5.7 million consisted of U.S. pretax loss of \$12.3 million and foreign pretax income of \$6.6 million, respectively. Pretax loss attributable to U.S. operations included amortization of identified intangible assets of \$3.1 million, stock-based compensation expenses of \$6.8 million, restructuring and other of \$3.3 million, change in contingent consideration of \$1.1 million, acquisition-related costs of \$0.7 million, and interest expense of \$4.9 million. Pretax loss attributable to foreign operations included amortization of identified intangible assets of \$9.0 million, restructuring and other of \$1.4 million, change in contingent consideration of \$0.4 million, and earnout interest accretion of \$0.2 million. The exclusion of these items from pretax loss would have resulted in U.S. and foreign pretax income of \$12.5 and \$9.7 million, respectively, during the three months ended March 31, 2018.

During the three months ended March 31, 2017, pretax income of \$3.8 million consisted of U.S. pretax loss of \$3.2 million and foreign pretax income of \$7.0 million, respectively. Pretax loss attributable to U.S. operations included amortization of identified intangibles of \$2.9 million, stock-based compensation of \$10.3 million, restructuring and other of \$0.7 million, acquisition-related costs of \$0.7 million, cost of revenue resulting from the fair value adjustment to FFPS inventory of \$0.4 million, and interest expense related to our Notes of \$4.2 million. Pretax income attributable to foreign operations included amortization of identified intangibles of \$7.9 million, restructuring and other of \$0.2 million, cost of revenue resulting from the fair value adjustment to FFPS inventory of \$0.6 million, earnout interest accretion of \$0.4 million, and change in fair value of contingent consideration of \$0.8 million. The exclusion of these items from pretax income would have resulted in U.S. and foreign pretax income of \$15.1 and \$16.8 million, respectively, during the three months ended March 31, 2017.



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### Provision for (Benefit from) Income Taxes

	Three Months Ended March 31,	
	2018	2017
Income Before Tax	\$ (5,730)	\$ 3,770
Provision for (benefit from) income taxes	(2,135)	(1,017)
Effective income tax rate	37.3%	-27.0%

The effective tax rate has increased from first quarter of 2018 to the same period in 2017, primarily due to decreased tax benefits related to both permanently reinvested foreign earnings and stock based compensation.

On December 22, 2017, the U.S. enacted the 2017 Tax Act, which will have wide ranging impacts including, but not limited to, lowering the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018, imposing a one-time deemed repatriation transition tax and the revaluation of U.S. deferred tax assets and liabilities. The 2017 Tax Act also created a minimum tax on certain foreign earnings, also known as the GILTI provision, commencing in the year ending December 31, 2018. The SEC issued SAB 118 which allows us to record a provisional estimate of the income tax effects of the 2017 Tax Act in the period in which we can make a reasonable estimate of its effects. We have recorded an additional provision of \$1.2 million for state deemed repatriation transition tax during the three months ended March 31, 2018. As we obtain additional information, we will record adjustments in subsequent periods, and will finalize the calculation of the income tax effects of the 2017 Tax Act in the fourth quarter of 2018, or in an earlier quarter if our analysis is complete.

We earn a significant amount of our operating income outside the U.S., which is deemed to be permanently reinvested in foreign jurisdictions. Of the income generated in jurisdictions with tax rates materially lower than the statutory U.S. tax rate of 21%, most is earned in the Netherlands, Spain, Italy, and the Cayman Islands. In 2017, we realigned the ownership of certain intellectual property to augment operational synergies and parallel both our worldwide intellectual property ownership and our worldwide supply chain. Our effective tax rate could fluctuate significantly and be adversely impacted if anticipated earnings in the foreign jurisdictions are significantly different than current projections.

While we currently do not foresee a need to repatriate the earnings of foreign operations, should we require more capital in the U.S. than our cash and cash equivalents and short-term investments located in the U.S., along with cash generated by our U.S. operations, we may elect to repatriate funds held in our foreign jurisdictions or raise capital in the U.S. through debt or equity issuances. These alternatives could result in higher effective tax rates, the cash payments of taxes and/or increased interest expense, and foreign income and withholding taxes. Due to the enactment of the 2017 Tax Act, we will not be subject to U.S. federal income tax on dividends received from our foreign subsidiaries commencing January 1, 2018. We are evaluating the potential foreign and U.S. state income tax liabilities that would result from future repatriations, if any, and how the 2017 Tax Act will impact our current permanent reinvestment assertion. We expect to complete this analysis and the impact, if any, which the 2017 Tax Act may have on our indefinite reinvestment assertion in the fourth quarter of 2018, or in an earlier quarter if our analysis is complete.

In *Altera Corp. v. Commissioner*, the U.S. Tax Court issued an opinion on July 27, 2015, related to the treatment of stock-based compensation expense in an intercompany cost-sharing arrangement. To date, the U.S. Department of the Treasury has not withdrawn the requirement to include stock-based compensation in intercompany cost-sharing arrangements from its regulations. Due to the uncertainty related to the status of the current regulations and the basis of the appeal that has been filed by the Internal Revenue Service, we have not recorded any benefit as of March 31, 2018, in our Condensed Consolidated Statement of Operations. We will continue to monitor ongoing developments and potential impacts to our condensed consolidated financial statements.

We assess the likelihood that our deferred tax assets will be recovered from future taxable income by considering both positive and negative evidence relating to their recoverability. If we believe that recovery of these deferred tax assets is not more likely than not, we establish a valuation allowance.

Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we considered all available evidence, including recent operating results, projections of future taxable income, our ability to utilize loss and credit carryforwards, and the feasibility of tax planning strategies. Other than valuation allowances on deferred tax assets related to California, Luxembourg, Israel, Netherlands, and Turkey deferred tax assets that will not be realized based on the size of the net operating loss and research and development credits being generated, we have determined that is more likely than not that we will realize the benefit related to all other deferred tax assets. To the extent we increase a valuation allowance, we will include an expense in the Condensed Consolidated Statement of Operations in the period in which such determination is made.

## Non-GAAP Financial Information

### Use of Non-GAAP Financial Information

To supplement our condensed consolidated financial results prepared in accordance with GAAP, we use non-GAAP measures of net income and earnings per diluted share that are GAAP net income and earnings per diluted share adjusted to exclude certain costs, expenses, and gains.

We believe the presentation of non-GAAP net income and non-GAAP earnings per diluted share provides important supplemental information regarding certain costs, expenses, gains, and significant items that we believe are important to understanding financial and business trends relating to our financial condition and results of operations. Non-GAAP net income and non-GAAP earnings per diluted share are among the primary indicators used by management as a basis for planning and forecasting future periods and by management and our Board of Directors to determine whether our operating performance has met specified targets and thresholds. Management uses non-GAAP net income and non-GAAP earnings per diluted share when evaluating operating performance because it believes the exclusion of the items described below, for which the amounts and/or timing may vary significantly depending on our activities and other factors, facilitates comparability of our operating performance from period to period. We have chosen to provide this information to investors so they can analyze our operating results in the same way that management does and use this information in their assessment of our business and the valuation of our Company.

### Use and Economic Substance of Non-GAAP Financial Measures

We compute non-GAAP net income and non-GAAP earnings per diluted share by adjusting GAAP net income and GAAP earnings per diluted share to remove the impact of the amortization of acquisition-related intangibles, stock-based compensation expense, non-cash settlement of employee-related liabilities, restructuring and other expenses including costs to integrate such acquisitions into our business, acquisition-related transaction expenses, incremental cost of revenue due to the fair value adjustment to inventories acquired in business acquisitions, changes in the fair value of contingent consideration including accretion and the related foreign exchange fluctuation impact, revenue recognition and accounting review costs, litigation settlement charges, and non-cash interest expense related to our Notes. We use a constant non-GAAP tax rate of 19%, which we believe reflects the long-term average tax rate based on our international structure and geographic distribution of revenue and profit.

Ex-Currency. To better understand trends in our business, we believe it is helpful to adjust our Condensed Consolidated Statements of Operations to exclude the impact of year-over-year changes in the translation of foreign currencies into U.S. dollars. This is a non-GAAP measure that is calculated by adjusting revenue, gross profit, and operating expenses by using historical exchange rates in effect during the comparable prior period and removing the balance sheet currency remeasurement impact from interest income and other income, net, including removal of any hedging gains and losses. We refer to these adjustments as “ex-currency”. Management believes the ex-currency measures provide investors with an additional perspective on year-over-year financial trends and enables investors to analyze our operating results in the same way management does. The year-over-year currency impact can be determined as the difference between year-over-year actual growth rates and year-over-year ex-currency growth rates.

These excluded items are described below:

- Cost of revenue related to fair value adjustment of the Free Flow Print Server business (“FFPS”). Inventory acquired in an acquisition must be recorded at fair value rather than historical cost in accordance with ASC 805. The fair value of FFPS inventory reflects the manufacturing cost plus a portion of the expected gross profit. In 2017, we adjusted our cost of revenue to reflect the expected gross profit that was included in the inventory valuation under ASC 805. We believe this adjustment is useful to investors to understand the gross profit trends of our ongoing business.
- Amortization of identified intangible assets. Intangible assets acquired to date are being amortized on a straight-line basis.
- Stock-based compensation expense recognized in accordance with ASC 718.
- Restructuring and other consists of:
  - Restructuring charges incurred as we consolidate the number and size of our facilities and, in addition, reduce the size of our workforce.
  - Expenses incurred to integrate acquired businesses of \$1.1 and \$0.5 million during the three months ended March 31, 2018 and 2017, respectively. We have acquired 18 businesses in the last 5 years, which have required significant information technology investment to integrate them into our business.

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- Acquisition-related transaction costs associated with businesses acquired during the periods reported and anticipated transactions were \$0.7 million for the three months ended March 31, 2018 and 2017.
- Changes in fair value of contingent consideration. Our management determined that we should analyze the total return provided by the investment when evaluating operating results of an acquired entity. The total return consists of operating profit generated from the acquired entity compared to the purchase price paid, including the final amounts paid for contingent consideration without considering any post-acquisition adjustments related to changes in the fair value of the contingent consideration. Because our management believes the final purchase price paid for the acquisition reflects the accounting value assigned to both contingent consideration and to the intangible assets, we exclude the GAAP impact of any adjustments to the fair value of acquisition-related contingent consideration from the operating results of an acquisition in subsequent periods, including the related foreign exchange fluctuation impact. We believe this approach is useful in understanding the long-term return provided by our acquisitions and that investors benefit from a supplemental non-GAAP financial measure that excludes the impact of this adjustment.
- Non-cash interest expense on our Notes. Our Notes may be settled in cash on conversion. We are required to separately account for the liability (debt) and equity (conversion option) components of the Notes in a manner that reflects our non-convertible debt borrowing rate. Accordingly, for GAAP purposes, we are required to amortize a debt discount equal to the fair value of the conversion option as interest expense on our \$345 million of 0.75% convertible senior notes that were issued in a private placement in September 2014 over the term of the Notes.
- Revenue Recognition and Accounting Review Costs. As described in “Item 9A, Controls and Procedures” of our 2017 Form 10-K, our management concluded that we had material weaknesses in our internal control over financial reporting as of December 31, 2017 related to revenue recognition practices, determination of inventory valuation at our Italian manufacturing subsidiary, and staffing levels within the Finance and Accounting function and, therefore, did not maintain effective internal control over financial reporting or effective disclosure controls and procedures, both of which are requirements of the Securities Exchange Act of 1934, as of that date. The review of our revenue recognition and inventory valuation practices has required that we expend significant management time and incur significant accounting, legal, and other expenses totaling \$0.6 million during the three months ended March 31, 2018, and we expect to incur additional costs in future periods. There were no comparable costs incurred in the three months ended March 31, 2017.
- Tax effect of non-GAAP adjustments. We use a constant non-GAAP tax rate of 19%, which we believe reflects the long-term average tax rate based on our international structure and geographic distribution of revenue and profit. The long-term average tax rate is calculated in accordance with the principles of ASC 740, Income Taxes, after excluding the tax effect of the non-GAAP items described above and \$1.2 million of tax charges recognized during the three months ended March 31, 2018 as a result of the 2017 Tax Act, which was enacted in December 22, 2017. During the three months ended December 31, 2017, we previously excluded a \$27.5 charge as a result of the 2017 Tax Act, which was enacted on December 22, 2017.

### **Usefulness of Non-GAAP Financial Information to Investors**

Our non-GAAP measures, including ex-currency, are not in accordance with or an alternative to GAAP and may be materially different from other non-GAAP measures, including similarly titled non-GAAP measures, used by other companies. The presentation of this additional information should not be considered in isolation from, as a substitute for, or superior to, revenue, gross profit, operating expenses, net income, or earnings per diluted share prepared in accordance with GAAP. Non-GAAP financial measures have limitations in that they do not reflect certain items that may have a material impact upon our reported financial results. We expect to continue to incur expenses of a nature similar to the non-GAAP adjustments described above, and exclusion of these items from our non-GAAP net income and non-GAAP earnings per diluted share should not be construed as an inference that these costs are unusual, infrequent, or non-recurring.

**RECONCILIATION OF GAAP NET INCOME (LOSS) TO NON-GAAP NET INCOME**  
(unaudited)

(in millions, except per share data)	Three Months Ended March 31,		
	2018	2017	Ex-Currency 2018
<b>Net income (loss)</b>	\$ (3.6)	\$ 4.8	\$ (3.6)
Cost of revenue adjustment — FFPS inventory valuation	—	1.0	—
Amortization of identified intangibles assets and in-process R&D	12.1	10.8	12.1
Ex-currency adjustment	—	—	(2.2)
Stock-based compensation	6.8	10.3	6.8
Restructuring and other	4.7	0.9	4.7
General and administrative:			
Acquisition-related transaction costs	0.7	0.7	0.7
Changes in fair value of contingent consideration	(1.3)	1.3	(1.3)
Revenue recognition and accounting review costs	0.6	—	0.6
Interest and other expense, net:			
Non-cash interest expense related to our Notes	3.4	3.2	3.4
Foreign exchange fluctuation related to contingent consideration	—	(0.1)	—
Balance sheet currency remeasurement impact	—	—	0.3
Tax effect of non-GAAP adjustments	(6.2)	(7.1)	(5.8)
<b>Non-GAAP net income</b>	<u>\$17.2</u>	<u>\$25.8</u>	<u>\$ 15.7</u>
Non-GAAP net income per diluted share	<u>\$0.38</u>	<u>\$0.55</u>	<u>\$ 0.34</u>
Shares for purposes of computing diluted non-GAAP net income per share	45.5	47.2	45.5

**RECONCILIATION OF GAAP REVENUE BY OPERATING SEGMENT TO  
NON-GAAP EX-CURRENCY**  
(unaudited)

(in millions)	Three months ended March 31,											
	GAAP			Ex-Currency			GAAP			Ex-Currency		
	2018	% of total	Ex-Currency Adjustments	2018	% of total	GAAP 2017	% of total	Change from 2017 GAAP		Change from 2017 GAAP		
								\$	%	\$	%	
Industrial Inkjet	\$142.2	59%	\$ (9.1)	\$133.1	58%	\$123.3	54%	\$ 18.9	15%	\$ 9.8	8%	
Productivity Software	43.8	18	(1.5)	42.3	18	35.0	15	8.8	25	7.3	21	
Fieri	53.9	23	(0.1)	53.8	24	70.4	31	(16.5)	(23)	(16.6)	(24)	
Total revenue	<u>\$239.9</u>	<u>100%</u>	<u>\$ (10.7)</u>	<u>\$229.2</u>	<u>100%</u>	<u>\$228.7</u>	<u>100%</u>	<u>\$ 11.2</u>	<u>5%</u>	<u>\$ 0.5</u>	<u>— %</u>	

**RECONCILIATION OF GAAP REVENUE BY GEOGRAPHIC AREA TO  
NON-GAAP EX-CURRENCY**  
(unaudited)

(in millions)	Three months ended March 31,											
	GAAP			Ex-Currency			GAAP			Ex-Currency		
	2018	% of total	Ex-Currency Adjustments	2018	% of total	GAAP 2017	% of total	Change from 2017 GAAP		Change from 2017 GAAP		
								\$	%	\$	%	
Americas	\$117.4	49%	\$ (0.4)	\$117.0	51%	\$109.9	48%	\$ 7.5	7%	\$ 7.1	6%	
EMEA	88.2	37	(8.3)	79.9	35	88.0	39	0.2	—	(8.1)	(9)	
APAC	34.3	14	(2.0)	32.3	14	30.8	13	3.5	12	1.5	5	
Total revenue	<u>\$239.9</u>	<u>100%</u>	<u>\$ (10.7)</u>	<u>\$229.2</u>	<u>100%</u>	<u>\$228.7</u>	<u>100%</u>	<u>\$ 11.2</u>	<u>5%</u>	<u>\$ 0.5</u>	<u>— %</u>	

**RECONCILIATION OF GROSS PROFIT BY OPERATING SEGMENT TO  
NON-GAAP EX-CURRENCY  
(unaudited)**

(in millions)	Three months ended March 31,			
	GAAP 2018	Ex-Currency Adjustments	Ex-Currency 2018	GAAP 2017
<b>Industrial Inkjet</b>				
Revenue	\$142.2	\$ (9.1)	\$ 133.1	\$123.3
Gross profit	49.7	(4.8)	44.9	49.1
Gross profit percentages	35.0%		33.7%	39.8%
<b>Productivity Software</b>				
Revenue	\$ 43.8	\$ (1.5)	\$ 42.3	\$ 35.0
Gross profit	31.4	(0.9)	30.5	25.6
Gross profit percentages	71.8%		72.2%	73.0%
<b>Fiery</b>				
Revenue	\$ 53.9	\$ (0.1)	\$ 53.8	\$ 70.4
Gross profit	38.8	(0.1)	38.7	49.7
Gross profit percentages	71.9%		71.9%	70.6%

Operating segment profit (i.e., gross profit) is reconciled to our Condensed Consolidated Statements of Operations during the periods presented below as follows (in thousands):

(in millions)	Three months ended March 31,			
	GAAP 2018	Ex-Currency Adjustments	Ex-Currency 2018	GAAP 2017
Segment gross profit	\$119.9	\$ (4.8)	\$ 115.1	\$124.4
Stock-based compensation expense	(0.8)	—	(0.8)	(0.9)
Gross profit	\$119.1	\$ (4.8)	\$ 114.3	\$123.5

**RECONCILIATION OF GAAP OPERATING EXPENSES TO  
NON-GAAP EX-CURRENCY  
(unaudited)**

(in millions)	Three Months Ended March 31,								
	GAAP 2018	Ex-Currency		GAAP				Ex-Currency	
		Adjustments	2018	Change from 2017 GAAP		Change from 2017 GAAP		2018	2017
				\$	%	\$	%		
Research and development	\$ 38.3	\$ (1.1)	\$ 37.2	\$ 39.6	\$ (1.3)	(3)%	\$ (2.4)	(6)%	
Sales and marketing	46.7	(2.3)	44.4	43.1	3.6	8	1.3	3	
General and administrative	19.4	(0.7)	18.7	21.0	(1.6)	(8)	(2.3)	(11)	
Restructuring and other	4.7	(0.2)	4.5	0.9	3.8	407	3.6	400	
Amortization of identified intangibles	12.1	(0.7)	11.4	10.8	1.3	13	0.6	6	
Total operating expenses	\$121.2	\$ (5.0)	\$116.2	\$115.4	\$ 5.8	5%	\$ 0.8	1%	

## Liquidity and Capital Resources

### Overview

Cash, cash equivalents, restricted cash equivalents, and short-term investments decreased by \$12.1 million to \$339.5 million as of March 31, 2018, from \$351.6 million as of December 31, 2017. The decrease was primarily due to repurchases under our stock repurchase program of \$17.6 million, cash payments for acquisition of property and equipment of \$4.2 million, and acquisition-related contingent consideration payments of \$0.7 million, partially offset by cash flows provided by operating activities of \$6.3 million and proceeds from ESPP purchases and stock option exercises of \$5.0 million.

(in thousands)	March 31, 2018	December 31, 2017	Change
Cash and cash equivalents	\$ 163,077	\$ 170,345	\$ (7,268)
Restricted cash equivalents	35,733	32,531	3,202
Short term investments	140,659	148,697	(8,038)
Total cash, cash equivalents, restricted cash equivalents, and short-term investments	<u>\$ 339,469</u>	<u>\$ 351,573</u>	<u>\$ (12,104)</u>

Cash flow activities are summarized for the periods presented below:

(in thousands)	Three months ended March 31,		
	2018	2017	Change
Net cash provided by operating activities	\$ 6,293	\$ 14,898	\$ (8,605)
Net cash provided by (used for) investing activities (1)	2,852	(7,441)	10,293
Net cash used for financing activities	(13,543)	(18,276)	4,733
Effect of foreign exchange rate changes on cash, cash equivalents and restricted cash equivalents	332	969	(637)
Decreases in cash, cash equivalents, and restricted cash equivalents	<u>\$ (4,066)</u>	<u>\$ (9,850)</u>	<u>\$ 5,784</u>

Cash, cash equivalents, restricted cash equivalents, and short-term investments held outside of the U.S. in various foreign subsidiaries were \$113.8 and \$88.4 million as of March 31, 2018, and December 31, 2017, respectively, and will be used to fund local operations and finance international acquisitions. Due to the enactment of the 2017 Tax Act, we are not able to estimate the foreign income and withholding taxes that would be incurred as a result of a repatriation to the U.S.

Based on past performance and current expectations, we believe that our cash, cash equivalents, short-term investments, and cash generated from operating activities will satisfy our working capital, capital expenditure, investment, stock repurchase, commitments (see Note 8 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements), and other liquidity requirements associated with our existing operations through at least the next twelve months. We believe that the most strategic uses of our cash resources include business acquisitions, strategic investments to gain access to new technologies, repurchase of shares of our common stock, and working capital.

### Operating Activities

During the three months ended March 31, 2018, our cash provided by operating activities was \$6.3 million.

Net cash provided by operating activities in the three months ended March 31, 2018 consisted primarily of a net loss of \$3.6 million, offset by non-cash expenses including \$17.1 million of depreciation and amortization, \$10.6 million of deferred taxes, \$6.8 million of stock-based compensation and \$3.8 million of non-cash accretion of interest expenses on Notes and imputed financing obligations, partially offset by the net change in operating assets and liabilities of \$29.0 million. The net change in operating assets and liabilities of \$29.0 million consisted primarily of increased accounts receivable of \$4.7 million, increased other current assets of \$12.3 million, decreased net income taxes payable of \$15.4 million, partially offset by decreased inventory of \$3.8 million.

### Accounts Receivable

Our primary source of operating cash flow is the collection of accounts receivable from our customers. One measure of the effectiveness of our collection efforts is average days sales outstanding for accounts receivable (“DSO”). DSOs were 94 and 84 days at March 31, 2018 and December 31, 2017, respectively. We calculate DSO by dividing net accounts receivable at the end of the quarter by revenue recognized during the quarter, multiplied by the total days in the quarter.

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DSOs increased during the three months ended March 31, 2018, compared with December 31, 2017, primarily due to a decrease in down payments in the period, extended payment terms on some larger contracts, and a greater portion of our revenue coming from our Industrial Inkjet and Productivity Software product lines which have substantially longer payment terms than our Fiery products. We expect DSOs to vary from period to period because of changes in the mix of business between direct customers and end user demand driven through the leading printer manufacturers, the effectiveness of our collection efforts both domestically and overseas, and variations in the linearity of our sales. As the percentage of Industrial Inkjet and Productivity Software related revenue increases, we expect DSOs will trend higher. Contributing to the higher DSOs in the current year quarter was the shift in product mix to a lower percentage of Fiery sales relative to our total sales. Our DSOs related to the Industrial Inkjet and Productivity Software operating segments are traditionally higher than those related to the significant printer manufacturer customers / distributors in our Fiery operating segment as, historically, these Fiery customers have been granted shorter payment terms and have paid on a more timely basis.

We have facilities in the U.S. and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables with recourse. Trade receivables sold with recourse are generally short-term receivables with payment due dates of less than 10 days from date of sale, which are subject to a servicing obligation. We also have facilities in Spain and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables without recourse. Trade receivables sold without recourse are generally short-term receivables with payment due dates of less than one year, which are secured by international letters of credit.

Trade receivables sold cumulatively under these facilities were \$3.2 and \$1.3 million during the three months ended March 31, 2018 on a recourse and nonrecourse basis, respectively, which approximates the cash received. The receivables that were sold to third parties were removed from the Condensed Consolidated Balance Sheet and were reflected as cash provided by operating activities in the Condensed Consolidated Statements of Cash Flows.

### Inventories

Our inventories are procured primarily in support of the Industrial Inkjet and Fiery operating segments. The majority of our Industrial Inkjet products are manufactured internally, while Fiery production is primarily outsourced. The result is lower inventory turnover for Industrial Inkjet inventories compared with Fiery inventories.

Our inventories decreased by \$2.0 million to \$123.8 million at March 31, 2018 from \$125.8 million at December 31, 2017 primarily due to the decrease in Industrial Inkjet inventories. Inventory turnover was 3.9 during the quarter ended March 31, 2018 compared with 4.4 turns during the quarter ended December 31, 2017 and 3.8 in the quarter ended March 31, 2017. We calculate inventory turnover by dividing annualized current quarter cost of revenue by ending inventories.

### *Investing Activities*

#### Acquisitions

In the first quarter of 2018, we paid \$0.3 million as a working capital purchase price adjustment on the acquisition of CRC Information Systems and Escada.

On January 31, 2017, we purchased the FFPS business from Xerox for cash consideration of \$5.9 million, plus \$18.0 million of future cash payments, of which \$9.0 million was paid in July 2017 and \$9.0 million is payable in July 2018. The FFPS business manufactures and markets the FFPS DFE, which is a DFE that previously competed with our Fiery DFE. We received a net working capital adjustment of \$0.2 million related to the Optitex acquisition during the first quarter of 2017, which was recorded as a purchase price adjustment.

#### Investments

Proceeds from sales and maturities of marketable securities, net of purchases, were \$7.3 and \$3.1 million during the three months ended March 31, 2018 and 2017, respectively. We have classified our investment portfolio as "available for sale." Our investments are made with a policy of capital preservation and liquidity as primary objectives. We may hold investments in fixed income debt securities to maturity; however, we may sell an investment at any time if the quality rating of the investment declines, the yield on the investment is no longer attractive, or we have better uses for the cash. Since we invest primarily in investment securities that are highly liquid with a ready market, we believe the purchase, maturity, or sale of our investments has no material impact on our overall liquidity.

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### Property and Equipment, Net

Our property and equipment additions have historically been funded with cash flows from operating activities. Net cash payments for purchases of property and equipment were \$4.2 and \$3.8 million during the three months ended March 31, 2018 and 2017, respectively. See also Note 1 – Basis of Presentation and Significant Accounting Policies of the Notes to Condensed Consolidated Financial Statements for additional information about purchases of property and equipment.

### Restricted Cash Equivalents and Investments

We have restricted cash equivalents and investments that are required to be maintained by the lease related to our Manchester, New Hampshire, construction project, which is described more fully in Note 8 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements.

The funds are invested in \$35.7 and \$32.5 million of cash equivalents as of March 31, 2018 and December 31, 2017, respectively, with a third-party trustee and are restricted during the construction period. Upon completion of construction, the funds will be released as cash and cash equivalents. The portion of released funds that represents 100% of the total expenditures made by MUFG will be deposited with MUFG and restricted as collateral until the end of the underlying lease period.

### *Financing Activities*

#### Proceeds from Issuance of Common Stock

Historically, our recurring cash flows provided by financing activities have included receipt of cash from the issuance of common stock through the exercise of stock options and employee purchases of ESPP shares. We received proceeds from the exercise of stock options of \$0.0 and \$0.8 million and employee purchases of ESPP shares of \$5.0 and \$5.1 million during the three months ended March 31, 2018 and 2017, respectively. While we may continue to receive proceeds from these plans in future periods, the timing and amount of such proceeds are difficult to predict and are contingent on certain factors including the price of our common stock, the timing and number of stock options exercised by employees that had participated in these plans, net settlement options, employee participation in our ESPP, and general market conditions. We anticipate that cash provided from the exercise of stock options will continue to decline as we have shifted to issuance of RSUs, rather than stock options.

#### Treasury Stock Purchases

The primary use of funds for financing activities during the three months ended March 31, 2018 and 2017 was \$17.6 and \$22.5 million, respectively, of cash used to repurchase outstanding shares of our common stock. Such repurchases included \$0.2 and \$5.0 million used for net settlement of shares for the exercise price of certain stock options and any tax withholding obligations incurred connected with such exercises and tax withholding obligations that arose on the vesting of RSUs during the three months ended March 31, 2018 and 2017, respectively.

On September 11, 2017, the board of directors approved an additional \$125 million for our share repurchase program commencing September 11, 2017. At that time, \$28.8 million remained available for repurchase under the 2015 authorization for this program. The 2017 authorization thereby increased the repurchase authorization to \$153.8 million of our common stock. This authorization expires December 31, 2018. Under this publicly announced plan, we repurchased 0.6 and 0.4 million shares for an aggregate purchase price of \$17.4 and \$17.5 million during the three months ended March 31, 2018 and 2017, respectively. As of March 31, 2018, \$92.0 million remained available for repurchases under the authorization.

#### Repayment of Imputed Financing Obligation Related to Build-to-Suit Lease

We paid \$0.3 and \$0.4 million of capital lease obligations during the three months ended March 31, 2018 and 2017, respectively.

#### Earmout Payments

Earmout payments during the three months ended March 31, 2018 and 2017 of \$0.7 and \$1.3 million are primarily related to previously accrued Shuttleworth contingent consideration liabilities.

#### Convertible Senior Notes

Our \$345 million principal amount Notes are due on September 1, 2019, unless previously purchased or converted in accordance with their terms prior to such date. The Company is currently evaluating various alternatives for refinancing all or a portion of the Notes prior to their maturity date.



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### *Other Commitments*

Our Industrial Inkjet inventories consist of materials required for our internal manufacturing operations and finished goods and sub-assemblies purchased from third-party contract manufacturers. Raw materials and finished goods, print heads, frames, digital UV curable ink, ceramic digital ink, various textile printing inks, and other components are required to support our internal manufacturing operations. Ceramic ink, branded textile ink, and certain sub-assemblies are purchased from third party contract manufacturers and branded third-party ink manufacturers.

Our Fiery inventory consists primarily of raw materials and finished goods, memory subsystems, processors, and ASICs, which are sold to third party contract manufacturers responsible for manufacturing our products. Should we decide to purchase components and manufacture Fiery DFEs internally, or should it become necessary for us to purchase and sell components other than memory subsystems, processors, and ASICs to our contract manufacturers, inventory balances and potentially property and equipment would increase significantly, thereby reducing our available cash resources. Further, the inventories we carry could become obsolete, thereby negatively impacting our financial condition and results of operations.

We are also reliant on several sole source suppliers for certain key components and could experience a significant negative impact on our financial condition and results of operations if such supplies were reduced or not available. From time to time we may find it necessary to purchase higher than normal levels of such supplies to provide safety stocks in case of supply disruptions. We may also be required to compensate our subcontract manufacturers for components purchased for orders subsequently cancelled by us. We periodically review the potential liability and the adequacy of the related allowance.

### *Indemnifications*

In the normal course of business and to facilitate the sales of our products, we sometimes indemnify other parties, including customers, lessors, and parties to other transactions with us. When we indemnify these parties, typically those provisions protect other parties against losses arising from our infringement of third party intellectual property rights or other claims made by third parties arising from the use or distribution of our products. Those provisions often contain various limitations including limits on the amount of protection provided.

As permitted under Delaware law, pursuant to our bylaws, charter, and indemnification agreements with our current and former executive officers, directors, and general counsel, we are required, subject to certain limited qualifications, to indemnify our executive officers, directors, and general counsel for certain events or occurrences while the executive officer, director, or general counsel is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the executive officer's, director's, or general counsel's lifetime. The maximum potential future payments we may be obligated to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and may enable us to recover a portion of any future amounts paid.

### *Off-Balance Sheet Financing*

Please refer to Note 8 – Commitments and Contingencies of our Notes to Condensed Consolidated Financial Statements for discussion of our six-year lease with MUFG for a 225,000 square foot manufacturing and warehouse facility under construction. Minimum lease payments during the initial six-year term for the building are \$1.8 million and minimum lease payments are \$13.1 million during the 48.5 year term of the land lease, excluding six months of the land lease that is financed into the manufacturing facility lease. Upon completion of the initial six-year term, we have the option to renew the lease, purchase the facility, or return the facility to MUFG subject to an 89% residual value guarantee under which we would recognize additional rent expense in the form of a variable rent payment. We have assessed our exposure in relation to the residual value guarantee and believe that there is no deficiency to the guaranteed value with respect to funds expended by MUFG as of March 31, 2018.

### *Contractual Obligations*

Please refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Contractual Obligations" presented in our 2017 Form 10-K. There were no material changes during the three months ended March 31, 2018.

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**Item 3: Quantitative and Qualitative Disclosures About Market Risk**

**Market Risk**

We are exposed to various market risks. Market risk is the potential loss arising from adverse changes in market rates and prices, general credit, foreign currency exchange rate fluctuations, liquidity, and interest rate risks, which may be exacerbated by the tight global credit market and increase in economic uncertainty that have affected various sectors of the financial market and continue to cause credit and liquidity issues. We do not enter into derivatives or other financial instruments for trading or speculative purposes. We may enter into financial instrument contracts to manage and reduce the impact of changes in foreign currency exchange rates on earnings and cash flows. The counterparties to such contracts are major financial institutions.

Europe represents a significant portion of our revenue and cash flow. Since Europe is composed of varied countries and regional economies, our European risk profile is somewhat more diversified due to the varying economic conditions among the countries. Approximately 29% of our receivables are with European customers as of March 31, 2018. Of this amount, 25% of our European receivables (7% of consolidated receivables) are in the higher risk southern European countries (mostly Italy, Spain, and Portugal), which management believes are adequately reserved.

*Marketable Securities*

We maintain an investment portfolio of short-term fixed income debt securities of various holdings, types, and maturities. These short-term investments are generally classified as available-for-sale and, consequently, are recorded on our Condensed Consolidated Balance Sheets at fair value with unrealized gains and losses reported as a separate component of OCI. We attempt to limit our exposure to interest rate risk by investing in securities with maturities of less than three years; however, we may be unable to successfully limit our risk to interest rate fluctuations. At any time, a sharp rise in interest rates could have a material adverse impact on the fair value of our investment portfolio. Conversely, declines in interest rates could have a material favorable impact on the fair value of our investment portfolio. Increases or decreases in interest rates could have a material impact on interest earnings related to new investments during the period. We do not currently hedge these interest rate exposures.

*Interest Rate Risk*

Hypothetical changes in the fair values of financial instruments held by us at March 31, 2018 that are sensitive to changes in interest rates are presented below. The modeling technique measures the change in fair value arising from selected potential changes in interest rates. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 100 basis points over a twelve-month time horizon (in thousands):

Valuation of securities given an interest rate decrease of 100 basis points	No change in interest rates	Valuation of securities given an interest rate increase of 100 basis points
\$ 148,011	\$ 146,394	\$ 144,774

We have no European sovereign debt investments. Our European debt and investments consisted of non-sovereign corporate debt securities of \$5.8 million, which represented 8% of our corporate debt instruments (4% of our short-term investments) at March 31, 2018. European debt investments are with corporations domiciled in the northern and central European countries of Sweden, Netherlands, and France. We do not have any short-term investments with corporations domiciled in the higher risk “southern European” countries (i.e., Italy, Spain, Greece, and Portugal) or in Ireland. We believe that we do not have significant exposure with respect to our money market and corporate debt investments in Europe.

As of March 31, 2018, we have \$345 million principal amount of Notes outstanding. We carry these instruments at face value less unamortized discount on our Condensed Consolidated Balance Sheets. Since these instruments bear interest at fixed rates, we have no financial statement risk associated with changes in interest rates. Although the fair value of these instruments fluctuates when interest rates change, the market value of our Notes is also influenced by the conversion premium. Please refer to Note 5 – Investments and Fair Value Measurements and Note 6 – Convertible Senior Notes, Note Hedges, and Warrants of the Notes to Condensed Consolidated Financial Statements.

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### *Foreign Currency Exchange Risk*

A large portion of our business is conducted in countries other than the U.S. We are primarily exposed to changes in exchange rates for the Euro, British pound sterling, Indian rupee, Japanese yen, Brazilian real, Chinese renminbi, Israeli shekel, and Australian dollar. Although the majority of our receivables are invoiced and collected in U.S. dollars, we have exposure from non-U.S. dollar-denominated sales (consisting of the Euro, British pound sterling, Brazilian real, Chinese renminbi, Israeli shekel, Australian dollar, and Canadian dollar) and operating expenses (primarily the Euro, British pound sterling, Brazilian real, Chinese renminbi, Israeli shekel, Japanese yen, Indian rupee, and Australian dollar) in foreign countries. We can benefit from or be adversely affected by either a weaker or stronger U.S. dollar relative to major currencies worldwide with respect to our condensed consolidated financial statements. Accordingly, we can benefit from a stronger U.S. dollar due to the corresponding reduction in our foreign operating expenses translated in U.S. dollars and at the same time we can be adversely affected by a stronger U.S. dollar due to the corresponding reduction in foreign revenue translated in U.S. dollars.

We hedge balance sheet remeasurement exposures using forward contracts not designated for hedge accounting treatment with notional amounts of \$243.5 million at March 31, 2018. Please refer to Note 10 – Derivatives and Hedging in our Notes to Condensed Consolidated Financial Statements for further information.

The impact of hypothetical changes in foreign exchanges rates on revenue and income from operations are presented below. The modeling technique measures the change in revenue and income from operations resulting from changes in selected foreign exchange rates with respect to the Euro, British pound sterling, and Chinese renminbi of plus or minus one percent during the three months ended March 31, 2018 as follows (in thousands):

	<u>Impact of a foreign exchange rate decrease of one percent</u>	<u>No change in foreign exchange rates</u>	<u>Impact of a foreign exchange rate increase of one percent</u>
Revenue	\$ 240,357	\$ 239,866	\$ 239,375
Loss from operations	(1,876)	(2,065)	(2,254)

### **Item 4: Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain “disclosure controls and procedures”, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, which are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management has evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2018, the end of the period covered by this interim report.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of March 31, 2018, due to material weaknesses in our internal control over financial reporting. Our internal control over financial reporting is the process designed by and under the supervision of our Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements for external reporting in accordance with accounting principles generally accepted in the United States of America.

As described in “Item 9A. Controls and Procedures” of our 2017 Form 10-K, management performed its assessment of the effectiveness of our internal control over financial reporting as of December 31, 2017, and concluded that our internal control over financial reporting as of that date was not effective because of the material weaknesses described below.

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Our management determined that, as of December 31, 2017, the following material weaknesses existed in our internal control over financial reporting.

1. Our internal controls were not designed effectively to ensure that operational changes, which may impact revenue recognition, were appropriately and timely evaluated to determine the accounting impact.
2. We did not sufficiently staff, with appropriate levels of experience and training, to allow for the adequate monitoring and timely communication of operational changes, including those which may impact revenue recognition on an ongoing basis.
3. Our internal control over excess and obsolete finished goods printer inventory reserves at our Italian manufacturing subsidiary was not designed effectively to conduct a sufficiently precise evaluation of the classification, condition, and salability of each printer and the cost accounting department was not staffed sufficiently to mitigate limitations relating to these reserves in the ERP system used solely at this subsidiary.

Items #1 and #2 resulted in management not timely identifying and evaluating the appropriate period of recognition for certain revenue transactions related to printers distributed from a single location, which should have been evaluated in accordance with the bill and hold revenue recognition guidance. Item #3 resulted in management not timely evaluating the appropriate period of de-recognition of certain printer inventory manufactured at our Italian manufacturing subsidiary, which should have been subject to an excess and obsolescence impairment or reclassification and depreciation.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected in a timely basis. Because the deficiencies identified could result in a misstatement of revenue, inventory, and related accounts and associated disclosures that could be material to the annual or interim consolidated financial statements, such deficiencies represent material weaknesses in our internal control over financial reporting. Management concluded that its internal control over financial reporting as of December 31, 2017 and March 31, 2018 was not effective due to the material weaknesses described above.

### **Material Weakness Discussion and Remediation**

Notwithstanding the material weaknesses in our internal control over financial reporting, we concluded that our previously issued consolidated financial statements and other financial information included in our filings fairly present in all material respects our financial condition, results of operations, and cash flows as of, and for, the periods presented. The foregoing has been approved by our management, including our Chief Executive Officer and Chief Financial Officer, who have been involved with the reassessment and analysis of our internal control over financial reporting.

The material weaknesses did not result in a material misstatement in the financial statements included in our 2017 Form 10-K, or previously issued financial statements; however, we concluded that, as of December 31, 2017, there was a reasonable possibility that material misstatements could occur in the consolidated financial statements.

### **Plan for Remediation of Material Weaknesses**

Following the identification of the foregoing material weaknesses, management commenced implementation of a remediation plan, which is ongoing. Management believes that the plan, once complete, will remediate the material weaknesses described above. The following steps of the remediation plan are currently in process, and management may determine to enhance existing controls and/or implement additional controls as the implementation progresses:

- Design and implement controls to properly identify, evaluate, and monitor operational changes, which may impact revenue recognition;
- Evaluate the sufficiency, experience, and training of our internal personnel and hire additional personnel or use external resources;
- Design and implement controls related to the approval and accounting for any bill and hold transactions;
- Design and implement controls to evaluate excess and obsolete inventory reserves at our Italian subsidiary; and
- Direct our internal auditors to perform additional testing of revenue transactions to ensure the sufficiency of our remediation efforts.

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We are in the process of further reviewing, documenting, and testing our internal controls over financial reporting, and we may from time to time make changes aimed at enhancing existing controls and/or implementing additional controls. Because the implementation of our remediation plan was ongoing as of December 31, 2017 and March 31, 2018, management concluded that the material weaknesses described in our amended annual report above, remained unremediated as of December 31, 2017 and March 31, 2018.

### **Important Considerations**

The effectiveness of our disclosure controls and procedures and our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, there can be no assurance that any system of disclosure controls and procedures or internal control over financial reporting will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management.

### **Evaluation of Changes in Internal Control over Financial Reporting**

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management has evaluated changes in our internal control over financial reporting that occurred during the first quarter of 2018. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer did not identify any change in our internal control over financial reporting during the first quarter of 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **Item 1: Legal Proceedings**

*We may be involved, from time to time, in a variety of claims, lawsuits, investigations, or proceedings relating to contractual disputes, securities laws, intellectual property rights, employment, or other matters that may arise in the normal course of business. We assess our potential liability in each of these matters by using the information available to us. We develop our views on estimated losses in consultation with inside and outside counsel, which involves a subjective analysis of potential results and various combinations of appropriate litigation and settlement strategies. We accrue estimated losses from contingencies if a loss is deemed probable and can be reasonably estimated.*

For a description of our significant pending legal proceedings, please see Note 8 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements.

### **Item 1A: Risk Factors**

In addition to information regarding risk factors that appears in “Management’s Discussion and Analysis – Forward-looking Statements” in Part I, Item 2, of this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A, and Part II, Items 7 and 7A, of the 2017 Form 10-K, which could materially affect our business, financial condition, or future results. The risks described herein and in our 2017 Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or operating results.

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[Table of Contents](#)**Item 2: Unregistered Sales of Equity Securities and Use of Proceeds****Issuer Purchases of Equity Securities**

Our stock repurchases during the three months ended March 31, 2018 are as follows (in thousands, except for per share amounts):

	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans (2)
January 2018	174	\$ 30.03	174	\$ 104,199
February 2018	229	28.12	224	97,890
March 2018	211	28.07	209	92,019
Totals	<u>614</u>		<u>607</u>	

- (1) The difference between total number of shares purchased and total number of shares purchased as part of publicly announced plans is the shares withheld by us to satisfy the exercise price of certain stock options and any tax withholding obligations incurred in connection with such exercises and the vesting of RSUs.
- (2) In November 2015, our board of directors authorized \$150 million for the repurchase of our outstanding common stock commencing January 1, 2016. On September 11, 2017, the board of directors approved an increase of \$125 million for our share repurchase program commencing September 11, 2017. At that time, \$28.8 million remained available for repurchase under the 2015 authorization. The 2017 authorization thereby increased the repurchase authorization to \$153.8 million of our common stock. This authorization expires December 31, 2018. Under this publicly announced plan, we repurchased 0.6 million shares for an aggregate purchase price of \$17.4 million during the three months ended March 31, 2018.

**Item 3: Defaults Upon Senior Securities**

None.

**Item 4: Mine Safety Disclosure**

Not applicable.

**Item 5: Other Information**

Not applicable.

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### **Item 6: Exhibits**

<u>No.</u>	<u>Description</u>
3.1	<a href="#">Amended and Restated Certificate of Incorporation <sup>(1)</sup></a>
3.2	<a href="#">Amended and Restated Bylaws of Electronics For Imaging, Inc. (as amended August 12, 2009) <sup>(2)</sup></a>
10.1	<a href="#">EFI 2018 Bonus Program</a>
12.1	<a href="#">Computation of Ratio of Earnings to Fixed Charges</a>
31.1	<a href="#">Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
31.2	<a href="#">Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
32.1	<a href="#">Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
(1)	Filed as an exhibit to the Company's Annual Report on Form 10-K filed on February 22, 2017 (File No. 000-18805) and incorporated herein by reference.
(2)	Filed as an exhibit to the Company's Current Report on Form 8-K filed on August 17, 2009 (File No. 000-18805) and incorporated herein by reference.

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**SIGNATURES**

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

ELECTRONICS FOR IMAGING, INC.

Date: May 8, 2018

/s/ Guy Gecht

Guy Gecht  
Chief Executive Officer  
(Principal Executive Officer)

Date: May 8, 2018

/s/ Marc Olin

Marc Olin  
Chief Financial Officer  
(Principal Financial and Accounting Officer)





[Section 16 Officers]

**EFI 2018 Bonus Program**

We are pleased to offer you participation in the EFI 2018 Bonus Program (the “Program”) on the terms below.

Each participant (the “Participant”) in the Program will, provided that the Participant remains employed by EFI through the date of grant of such awards, be granted an award of restricted stock units that is subject to vesting requirements based on the performance of Electronics For Imaging, Inc. (“EFI” or the “Company”) for 2018 and the Participant’s continued employment as set forth below.

**Equity Bonus and Performance Targets**

Your Target Equity Bonus Eligibility amount is:

Target Equity Bonus Eligibility: [\$]

Number of RSUs granted for Target Bonus: [\*\*\*\*\*]

Total Granted RSUs (including Maximum Overachievement of Performance Metrics): [\*\*\*\*\*]

The performance goals applicable to your equity bonus opportunity are:

Component % of Total Award		Threshold	Target Achievement	Target Over- Achievement
<b>40%</b>	<b>Company Revenue</b>	\$ <u>    </u> M	\$ <u>    </u> M	\$ <u>    </u> M
	(% of bonus earned for this Component)	0%	100%	200%
	(% of RSU award vesting for this Component)	0%	50%	100%
<b>40%</b>	<b>Company Non-GAAP Operating Income</b>	\$ <u>    </u> M	\$ <u>    </u> M	\$ <u>    </u> M
	(% of bonus earned for this Component)	0%	100%	200%
	(% of RSU award vesting for this Component)	0%	50%	100%
<b>20%</b>	<b>Cash From Operations as a Percentage of Non-GAAP Net Income (Company)</b>	<u>    </u> %	<u>    </u> %	<u>    </u> %
	(% of bonus earned for this Component)	0%	100%	200%
	(% of RSU award vesting for this Component)	0%	50%	100%

**Target Achievement Metrics**

If the Company’s performance for a Program Component is at or above the threshold level set forth above, a percentage of the Total Granted RSUs associated with that Program Component will vest on a pro-rata, straight-line basis between 0% and 50%, starting at 0% at or below the Threshold level for that Program Component up to 50% at the Target level for that Program Component (representing 100% Target Bonus Achievement earned for that component).

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### **Overachievement Metrics**

If the Company's performance for a Program Component is at or above the Target Achievement level set forth above, a percentage of the Total Granted RSUs associated with that Program Component will vest on a pro-rata, straight-line basis between 50% and 100%, starting at 50% at the Target Achievement level for that Program Component up to 100% at or above the Overachievement level for that Program Component (representing 200% Target Bonus Achievement earned for that component).

The number of Total Granted RSUs that vest will be determined based on the Company's performance in 2018 for each Program Component, as certified by the Compensation Committee.

The total number of RSUs that vest will be calculated by *multiplying* (a) the vesting percentage for each Program Component of your award *times* (b) the number of RSUs associated with the corresponding Program Component based on the Component Percentage of Total Award set forth above and the actual number of RSUs granted to you in your RSU Award, and (c) adding together the resulting number of RSUs (if any) associated with each Program Component, each rounded down to the nearest whole share. The sum of the numbers described in subsection (c) of the previous sentence shall be the number of Total Granted RSUs that vest.

### **Performance Equity Bonus Terms**

- Per the approval by the Company's Board of Directors' Compensation Committee (the "Compensation Committee") and subject to your continued employment with the Company through the date of grant, you will be granted a performance-based restricted stock unit ("RSU") award with respect to the Program. The RSU award (the "RSU Award") will be subject to vesting based on the achievement of the Company performance goals for 2018 as set forth above (the "Program Components") and your continued employment as set forth below.
- The number of RSUs that you will be granted will equal your "Target Equity Bonus Eligibility" amount (expressed in U.S. Dollars) above, divided by the closing price of EFI's common stock on March 31, 2018, multiplied by two to reflect the maximum possible overachievement of the Company performance metrics above (in total, the "Total Granted RSUs"). The total number of RSUs granted will be rounded down to the nearest whole share.
- The RSUs will be granted under and will be subject to the terms and conditions of EFI's 2017 Equity Incentive Plan, as amended (the "2017 Equity Plan") and the restricted stock unit award notice and restricted stock unit award agreement used by EFI to evidence RSU awards granted under the 2017 Equity Plan (the "Award Agreement"), except as otherwise expressly set forth herein. Each RSU Award will have a grant date that is the grant date that the Compensation Committee approves for such award (the "Grant Date"). The RSU Award is also subject to the individual and other share limits of the 2017 Plan.
- During the first quarter of 2019, the Program Administrator (as defined below) will determine whether (and the extent to which) the performance conditions applicable to the RSUs were achieved for 2018, subject to approval by the Compensation Committee (the date of the Compensation Committee's approval is referred to as the "Determination Date"). Subject to your continued employment by the Company through the applicable Vesting Date, if the Program Administrator determines that the applicable performance condition related to the RSUs was achieved for 2018, subject to the Compensation Committee's approval, the related RSUs will vest (the "Vesting Date") on the later of (1) March 20, 2019 or (2) the vesting date as determined by the Compensation Committee on the Determination Date (such vesting date to be no more than four business days after the Determination Date). Each RSU that vests in accordance with the terms of the Program will be paid in one share of the Company's common stock as soon as practicable after (and in all events within two and one-half months after) the Vesting Date.

**Maximum Award** - In no event shall the RSU Award vest with respect to more than 100% of the Total Granted RSUs.

**Non-GAAP Operating Income** is defined as operating income determined in accordance with GAAP, as adjusted to remove the impact of certain recurring and non-recurring expenses, in each case consistent with the determination of non-GAAP operating income in the Company's financial reporting.

**Non-GAAP Net Income** is defined as net income determined in accordance with GAAP, as adjusted to remove the impact of certain expenses and gains and the tax effect of these adjustments, in each case consistent with the determination of non-GAAP net income in the Company's financial reporting.

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**Adjustments** - The results will be adjusted for certain material items which are not included in the original calculation of the performance targets as follows:

(a) Bookings achieved in 2018 and revenue deferred from 2018 into a subsequent reporting period will be included in calculation of the achievement of the performance metrics; and

(b) Revenue and operating income from each acquisition completed during 2018 will be used to calculate the achievement of the performance metrics to the extent that such revenue and operating income are generated through sales by Company sales channels existing prior to the completion each such acquisition; revenue and operating income generated by sales channels acquired as part of each such acquisition will not be included (Company sales channels shall be defined as all existing sales channels, both direct and indirect, that sell Company products in advance of the acquisition); and

(c) All performance metrics targets shall be adjusted using the January 2018 currency exchange rates used in the preparation of the Company's 2018 Annual Operating Plan.

The number of RSUs that vest (if any) will be rounded down to the nearest whole share, and is subject to your continued employment in good standing through the date of vesting. Any portion of the award that does not vest (including as a result of the failure to satisfy either or both of the Conditions or the failure to achieve the target level of performance indicated above) will terminate and you will have no rights with respect thereto.

#### **Other Terms**

##### **Program Participants**

Participants in this Program are not eligible for participation in other variable compensation arrangement, program or plan, such as commission-based plans or other similar plans, for 2018.

##### **Leaves of Absences**

Periods of leave of absence will be considered when determining the vesting of the RSU Award. Specifically, RSU vesting will (unless otherwise required by applicable law) be calculated on a pro-rata basis excluding any leave of absence period(s) during the applicable Program Year.

##### **Termination of Employment**

Except as may otherwise be expressly provided below, you will have no right to any bonus for 2018 and no right to any payment with respect to your RSUs for 2018 (and your RSUs will automatically and immediately terminate and you will have no right with respect thereto) should you cease to be employed by the Company or one of its subsidiaries before the Vesting Date set forth above (regardless of the reason for such termination of employment).

Notwithstanding anything to the contrary in the Award Agreement or your written employment agreement (if any) with the Company, if you are involuntarily terminated Without Cause or are terminated for Good Reason outside of a Change of Control (as these terms are defined in the applicable employment agreement), you will be eligible for pro-rata vesting of your RSUs related to this Program. The pro-rata RSU vesting will be determined with respect to the number of RSUs that would have vested under this Program had your employment continued through the Vesting Date, multiplied by a fraction (x) the numerator of which is the number of whole months you were employed by the Company during 2018, and (y) the denominator of which is twelve. Payment of such pro-rata amount will be made at the same time that payment would have been made had you continued to be employed through the Vesting Date. In the event that you are entitled to a pro-rata payment of your RSUs, payment may, at EFI's discretion, be made in cash (as opposed to shares or other property) with the cash payment in respect of a vested RSU to equal (subject to applicable tax withholding) the closing price of a share of EFI common stock on the Determination Date.

With respect to any RSUs granted under this Program, in the event of any conflict between the provisions of your employment agreement regarding acceleration of performance equity outside of a Change of Control and this Program, this Program shall control.

##### **No Right to Continued Employment**

Nothing contained in this Program, the RSUs, or any related document constitutes an employment or service commitment by the Company (or any affiliate), affects your status (if you are employed at will) as an employee at will who is subject to termination at any time and for any reason, confers upon you any right to remain employed by or in service to the Company (or any affiliate), or interferes in any way with the right of the Company (or any affiliate) to terminate your employment or to change your compensation or other terms of employment at any time.

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**Program Administration and Interpretation**

With respect to EFI's executive officers, the Program will be administered by, and interpretation of the Program, as it may apply to any one individual person, matter or circumstance, will be made by the Compensation Committee (the "Program Administrator"). This Program is not intended and shall not be construed to imply an employment contract between EFI and any of its employees. In the event of any conflict between the provisions of the Program and the Award Agreement, this Program shall control. All actions taken and all interpretations and determinations made by the Program Administrator in respect of such documents and matters shall be conclusive and binding on all persons and shall be given the maximum deference permitted by law.

**Clawback Policy**

This Program, the RSU Award, any securities or other consideration you may receive in payment of or with respect to the RSU Award, as well as any bonus opportunity under this Program, is subject to the terms of the EFI recoupment, clawback or similar policy as it may be in effect from time to time, as well as any similar provisions of applicable law, any of which could in certain circumstances require repayment or forfeiture of your bonus, awards or any shares of stock or other cash or property received with respect to your bonus or awards (including any value received from a disposition of any shares of stock you may receive in payment of the RSU Award).

**Construction**

This Program and the RSU Award contemplated above are also intended to satisfy, and not be subject to any tax, penalty or interest under, Section 409A of the Internal Revenue Code. These arrangements shall be construed in accordance with such intents.

**Program Changes and Duration of the Program**

This Program is effective as of January 1, 2018. It supersedes all prior performance based bonus programs and shall not be modified or terminated unless authorized in writing by the Program Administrator and/or approved by the Compensation Committee. The Company reserves the right to modify, change or terminate the Program at any time including to revise goals, corporate objectives or to correct bona fide errors in the Program, or for any other reason. Notices of such changes will be made in writing or via electronic mail to all Participants affected by such changes.

These terms apply to the Program Year 2018 only and your bonus eligibility, targets, and any unvested RSUs do not carry over to the following year.

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*By signing below, you acknowledge and accept that the potential value of your award is subject to market risk and any decline in EFI's common stock price may result in a lower realizable value upon vesting. You agree that any decline in the stock price impacting your bonus shall not be the responsibility of the Company and shall not constitute Good Reason under your employment agreement. You agree that your award is subject to termination as described above, and that you may not be eligible for any cash bonus with respect to 2018.*

*I have read and understand the terms of this Program and the documents referred to herein, I acknowledge and agree to the preceding paragraph and to all of the terms and conditions of this Program and such other documents.*

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[Participant Name]

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[Date]

**Electronics For Imaging, Inc.**  
**Computation of Ratio of Earnings to Fixed Charges**  
(in thousands, except for ratio of earnings to fixed charges)

	Years Ended December 31,					Three Months Ended
	2013	2014	2015	2016	2017	March 31, 2018
Income (loss) from continuing operations before income taxes	\$173,138	\$42,087	\$37,522	\$39,382	\$12,130	\$ (5,730)
Fixed charges:						
Interest expense	3,406	5,859	17,364	17,716	19,505	4,954
Interest relating to rental expense <sup>(1)</sup>	2,024	2,039	2,530	2,924	3,602	1,023
Total fixed charges	5,430	7,898	19,894	20,640	23,107	5,977
Earnings available for fixed charges	\$178,568	\$49,985	\$57,416	\$60,022	\$35,237	\$ 247
Ratio of earnings to fixed charges	32.89	6.33	2.89	2.91	1.52	0.04

- (1) The representative interest portion of rental expense was deemed to be one-third of all rental expense, except for the rental expense related to off-balance sheet financing leases, which was deemed to be all interest.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Guy Gecht, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Electronics For Imaging, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2018

/s/ Guy Gecht

\_\_\_\_\_  
Guy Gecht

Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Marc Olin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Electronics For Imaging, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2018

/s/ Marc Olin

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Marc Olin  
Chief Financial Officer

**CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER & CHIEF FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Electronics For Imaging, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2018 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 8, 2018

/s/ Guy Gecht

Guy Gecht  
Chief Executive Officer

Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Electronics For Imaging, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2018 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 8, 2018

/s/ Marc Olin

Marc Olin  
Chief Financial Officer



