

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended: June 30, 2019

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

For the Transition Period from _____ to _____

Commission file number 001-34702

SPS COMMERCE, INC.



(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

41-2015127
(I.R.S. Employer
Identification No.)

333 South Seventh Street, Suite 1000, Minneapolis, MN 55402
(Address of Principal Executive Offices, Including Zip Code)

(612) 435-9400
(Registrant's Telephone Number, Including Area Code)

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

Title of each class	Trading Symbol	Name of exchange on which registered
Common Stock, par value \$0.001 per share	SPSC	The Nasdaq Stock Market LLC (Nasdaq Global Market)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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.

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.

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 the registrant's common stock, par value \$0.001 per share, outstanding at July 19, 2019 was 17,441,603 shares.

SPS COMMERCE, INC.
QUARTERLY REPORT ON FORM 10-Q
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Unless the context otherwise requires, for purposes of the Quarterly Report on Form 10-Q, the words "we," "us," "our," the "Company" and "SPS" refer to SPS Commerce, Inc.

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward looking statements regarding us, our business prospects and our results of operations are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under the heading “*Risk Factors*” included in our Annual Report on Form 10-K/A for the year ended December 31, 2018 as filed with the Securities and Exchange Commission (“SEC”). Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. In some cases, you can identify forward-looking statements by the following words: “anticipate,” “assumes,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “ongoing,” “plan,” “potential,” “predict,” “project,” “should,” “will,” “would,” or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words. We expressly disclaim any intent or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC that advise interested parties of the risks and factors that may affect our business.

PART I. – FINANCIAL INFORMATION

Item 1. Financial Statements

SPS COMMERCE, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited; in thousands, except per share amounts)

	June 30, 2019	December 31, 2018
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 147,023	\$ 133,859
Short-term investments	51,651	44,537
Accounts receivable, less allowance for doubtful accounts of \$1,435 and \$1,392, respectively	30,747	27,488
Deferred costs	35,087	34,502
Other current assets	8,265	9,229
Total current assets	272,773	249,615
PROPERTY AND EQUIPMENT, less accumulated depreciation of \$46,412 and \$41,175, respectively	20,597	20,957
OPERATING LEASE RIGHT-OF-USE ASSETS	14,038	—
GOODWILL	70,300	69,658
INTANGIBLE ASSETS, net	20,379	22,741
OTHER ASSETS		
Deferred costs	10,441	10,973
Deferred income tax asset	7,627	10,456
Other assets	2,452	1,723
Total assets	\$ 418,607	\$ 386,123
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 3,708	\$ 4,440
Accrued compensation	15,883	20,415
Accrued expenses	4,964	4,558
Deferred revenue	30,376	25,328
Deferred rent	—	1,781
Operating lease liabilities	3,469	—
Total current liabilities	58,400	56,522
OTHER LIABILITIES		
Deferred revenue	2,714	2,512
Deferred rent	—	5,371
Operating lease liabilities	16,890	—
Deferred income tax liability	1,246	1,376
Other non-current liabilities	1,024	1,368
Total liabilities	80,274	67,149
COMMITMENTS and CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding	—	—
Common stock, \$0.001 par value; 55,000,000 shares authorized; 17,971,845 and 17,757,628 shares issued; and 17,468,106 and 17,345,736 outstanding, respectively	18	18
Treasury stock, at cost; 503,739 and 411,892 shares, respectively	(34,645)	(25,679)
Additional paid-in capital	344,250	332,592
Retained earnings	30,870	15,261
Accumulated other comprehensive loss	(2,160)	(3,218)
Total stockholders' equity	338,333	318,974
Total liabilities and stockholders' equity	\$ 418,607	\$ 386,123

See accompanying notes to these condensed consolidated financial statements.

SPS COMMERCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited; in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Revenues	\$ 68,529	\$ 61,091	\$ 135,463	\$ 120,183
Cost of revenues	23,700	20,402	45,067	40,160
Gross profit	44,829	40,689	90,396	80,023
Operating expenses				
Sales and marketing	17,545	18,424	35,467	37,071
Research and development	6,509	5,293	12,701	10,425
General and administrative	10,179	9,974	22,949	20,104
Amortization of intangible assets	1,266	1,033	2,570	2,158
Total operating expenses	35,499	34,724	73,687	69,758
Income from operations	9,330	5,965	16,709	10,265
Other income (expense)				
Interest income, net	813	547	1,390	961
Other income (expense), net	240	(168)	193	(322)
Change in earn-out liability	400	—	344	—
Total other income, net	1,453	379	1,927	639
Income before income taxes	10,783	6,344	18,636	10,904
Income tax expense	1,987	928	3,027	2,234
Net income	\$ 8,796	\$ 5,416	\$ 15,609	\$ 8,670
Other comprehensive income (expense)				
Foreign currency translation adjustments	291	(1,176)	\$ 1,030	\$ (2,231)
Unrealized gain on investments, net of tax of \$37, \$34, \$67, and \$47, respectively	110	102	\$ 200	\$ 141
Reclassification of gain on investments into earnings, net of tax of (\$29), (\$45), (\$60) and (\$53), respectively	(88)	(134)	\$ (180)	\$ (158)
Total other comprehensive income (expense)	313	(1,208)	1,050	(2,248)
Comprehensive income	\$ 9,109	\$ 4,208	\$ 16,659	\$ 6,422
Net income per share				
Basic	\$ 0.50	\$ 0.32	\$ 0.89	\$ 0.51
Diluted	\$ 0.49	\$ 0.31	\$ 0.87	\$ 0.50
Weighted average common shares used to compute net income per share				
Basic	17,505	17,163	17,488	17,140
Diluted	18,010	17,549	18,003	17,446

See accompanying notes to these condensed consolidated financial statements.

SPS COMMERCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited; in thousands, except share amounts)

	Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balances, March 31, 2018	<u>17,109,949</u>	<u>\$ 17</u>	<u>236,131</u>	<u>\$ (11,686)</u>	<u>\$ 305,759</u>	<u>\$ (5,357)</u>	<u>\$ (383)</u>	<u>\$ 288,350</u>
Stock-based compensation	—	—	—	—	2,887	—	—	2,887
Exercise of stock options and issuance of restricted stock	109,037	—	—	—	4,405	—	—	4,405
Employee stock purchase plan	20,243	—	—	—	836	—	—	836
Repurchases of common stock	(79,410)	—	79,410	(5,998)	—	—	—	(5,998)
Net income	—	—	—	—	—	5,416	—	5,416
Foreign currency translation adjustments	—	—	—	—	—	—	(1,176)	(1,176)
Reclassification of gain on investments into earnings, net of tax	—	—	—	—	—	—	(134)	(134)
Unrealized gain on investments, net of tax	—	—	—	—	—	—	102	102
Balances, June 30, 2018	<u>17,159,819</u>	<u>\$ 17</u>	<u>315,541</u>	<u>(17,684)</u>	<u>313,887</u>	<u>59</u>	<u>(1,591)</u>	<u>294,688</u>
Balances, March 31, 2019	<u>17,467,682</u>	<u>\$ 18</u>	<u>445,624</u>	<u>\$ (28,645)</u>	<u>\$ 339,730</u>	<u>\$ 22,074</u>	<u>\$ (2,473)</u>	<u>\$ 330,704</u>
Stock-based compensation	—	—	—	—	2,542	—	—	2,542
Exercise of stock options and issuance of restricted stock	43,132	—	—	—	899	—	—	899
Employee stock purchase plan	15,407	—	—	—	1,079	—	—	1,079
Repurchases of common stock	(58,115)	—	58,115	(6,000)	—	—	—	(6,000)
Net income	—	—	—	—	—	8,796	—	8,796
Foreign currency translation adjustments	—	—	—	—	—	—	291	291
Reclassification of gain on investments into earnings, net of tax	—	—	—	—	—	—	(88)	(88)
Unrealized gain on investments, net of tax	—	—	—	—	—	—	110	110
Balances, June 30, 2019	<u>17,468,106</u>	<u>\$ 18</u>	<u>503,739</u>	<u>\$ (34,645)</u>	<u>\$ 344,250</u>	<u>\$ 30,870</u>	<u>\$ (2,160)</u>	<u>\$ 338,333</u>

	Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balances, December 31, 2017	<u>17,127,006</u>	<u>\$ 17</u>	<u>122,147</u>	<u>\$ (5,815)</u>	<u>\$ 301,863</u>	<u>\$ (8,611)</u>	<u>\$ 657</u>	<u>\$ 288,111</u>
Stock-based compensation	—	—	—	—	6,068	—	—	6,068
Exercise of stock options and issuance of restricted stock	205,964	—	—	—	5,120	—	—	5,120
Employee stock purchase plan	20,243	—	—	—	836	—	—	836
Repurchases of common stock	(193,394)	—	193,394	(11,869)	—	—	—	(11,869)
Net income	—	—	—	—	—	8,670	—	8,670
Foreign currency translation adjustments	—	—	—	—	—	—	(2,231)	(2,231)
Reclassification of gain on investments into earnings, net of tax	—	—	—	—	—	—	(158)	(158)
Unrealized gain on investments, net of tax	—	—	—	—	—	—	141	141
Balances, June 30, 2018	<u>17,159,819</u>	<u>\$ 17</u>	<u>315,541</u>	<u>\$ (17,684)</u>	<u>\$ 313,887</u>	<u>\$ 59</u>	<u>\$ (1,591)</u>	<u>\$ 294,688</u>
Balances, December 31, 2018	<u>17,345,736</u>	<u>\$ 18</u>	<u>411,892</u>	<u>\$ (25,679)</u>	<u>\$ 332,592</u>	<u>\$ 15,261</u>	<u>\$ (3,218)</u>	<u>\$ 318,974</u>
Stock-based compensation	—	—	—	—	7,508	—	—	7,508
Exercise of stock options and issuance of restricted stock	201,571	—	—	—	3,371	—	—	3,371
Employee stock purchase plan	15,407	—	—	—	1,079	—	—	1,079
Repurchases of common stock	(91,847)	—	91,847	(8,966)	—	—	—	(8,966)
Settlement and subsequent return of shares	(2,761)	—	—	—	(300)	—	—	(300)
Net income	—	—	—	—	—	15,609	—	15,609
Foreign currency translation adjustments	—	—	—	—	—	—	1,030	1,030
Reclassification of gain on investments into earnings, net of tax	—	—	—	—	—	—	(180)	(180)
Unrealized gain on investments, net of tax	—	—	—	—	—	—	200	200
Adoption of ASU 2018-02	—	—	—	—	—	—	8	8
Balances, June 30, 2019	<u>17,468,106</u>	<u>\$ 18</u>	<u>503,739</u>	<u>\$ (34,645)</u>	<u>\$ 344,250</u>	<u>\$ 30,870</u>	<u>\$ (2,160)</u>	<u>\$ 338,333</u>

See accompanying notes to these condensed consolidated financial statements.

SPS COMMERCE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in thousands)

	Six Months Ended June 30,	
	2019	2018
Cash flows from operating activities		
Net income	\$ 15,609	\$ 8,670
Reconciliation of net income to net cash provided by operating activities		
Deferred income taxes	2,634	1,498
Change in earn-out liability	(344)	—
Depreciation and amortization of property and equipment	5,324	4,176
Amortization of intangible assets	2,570	2,158
Provision for doubtful accounts	1,504	985
Stock-based compensation	8,169	6,712
Other, net	(357)	(211)
Changes in assets and liabilities		
Accounts receivable	(4,769)	(4,373)
Deferred costs	(56)	(2,621)
Other current and non-current assets	(549)	(710)
Accounts payable	(490)	189
Accrued compensation	(5,210)	(1,464)
Accrued expenses	404	62
Deferred revenue	5,250	6,237
Deferred rent	—	939
Operating leases	(27)	—
Net cash provided by operating activities	<u>29,662</u>	<u>22,247</u>
Cash flows from investing activities		
Purchases of property and equipment	(5,351)	(6,481)
Purchases of investments	(44,548)	(52,116)
Maturities of investments	37,725	45,000
Acquisitions of businesses and intangible assets, net of cash acquired	—	(381)
Net cash used in investing activities	<u>(12,174)</u>	<u>(13,978)</u>
Cash flows from financing activities		
Repurchases of common stock	(8,966)	(11,869)
Net proceeds from exercise of options to purchase common stock	3,371	5,120
Net proceeds from employee stock purchase plan	1,079	836
Net cash used in financing activities	<u>(4,516)</u>	<u>(5,913)</u>
Effect of foreign currency exchange rate changes	192	(98)
Net increase in cash and cash equivalents	13,164	2,258
Cash and cash equivalents at beginning of period	133,859	123,127
Cash and cash equivalents at end of period	<u>\$ 147,023</u>	<u>\$ 125,385</u>

See accompanying notes to these condensed consolidated financial statements.

NOTE A – General

Business Description

SPS Commerce is a leading provider of cloud-based supply chain management solutions that make it easier for retailers, suppliers, grocers, distributors and logistics firms to orchestrate the management of item data, order fulfillment, inventory control and sales analytics across all channels. The solutions offered by SPS Commerce eliminate the need for on-premise software and support staff by taking on that capability on the customer's behalf. The solutions SPS Commerce provides allow our customers to increase their supply cycle agility, optimize their inventory levels and sell-through, reduce operational costs and gain increased visibility into customer orders, ensuring that suppliers, grocers, distributors, and logistics firms can satisfy exacting retailer requirements.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of SPS Commerce, Inc. and its subsidiaries. All intercompany accounts and transactions have been eliminated in the condensed consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these condensed consolidated financial statements do not include all of the information and notes required by GAAP. We have included all normal recurring adjustments considered necessary to provide a fair presentation of our financial position, results of operations, stockholders' equity, and cash flows for the interim periods shown. Operating results for these interim periods are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and accompanying notes for the year ended December 31, 2018 included in our Annual Report on Form 10-K/A filed with the SEC.

Effective January 1, 2019, we adopted the requirements of Accounting Standards Update ("ASU") No. 2016-02, *Leases (Topic 842)*, and used the effective date as our date of initial application. Consequently, financial information was not updated and the disclosures required under the new standard were not provided for dates and periods before January 1, 2019. The new standard provides several optional practical expedients in transition. We elected the "package of practical expedients," which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We did not elect the use-of hindsight or the practical expedient pertaining to land easements, the latter not being applicable to us. The new standard also provides practical expedients for an entity's ongoing accounting. We elected the short-term lease recognition exemption for all leases that qualify, which means we will not recognize right-of-use ("ROU") assets or lease liabilities for these leases. This includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. We also elected the practical expedient to not separate lease and non-lease components for all leases.

Use of Estimates

Preparing financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Lease Policy

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease ROU assets, current lease liabilities, and long-term lease liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. We estimate the discount rate for a similar collateralized asset by reviewing quoted costs of borrowing. We use the implicit interest rate when readily determinable. The operating lease ROU asset also includes any lease payments made and lease incentives that have been incurred. The options to extend our leases are not recognized as part of our right-of-use assets and lease liabilities unless it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term. For all leases we combine non-lease components with the related lease components and account for it as a single lease component. The ROU assets are subject to the same impairment process as our long-lived assets. Additionally, we review our lease liabilities for remeasurement whenever there is a triggering event or when relevant facts and circumstances change.

Recently Adopted Accounting Pronouncements

Standard	Date of Issuance	Description	Date Adopted	Effect on the Financial Statements
ASU 2016-02 , Leases and all related amendments	February 2016	Requires all leases with a term greater than 12 months to be recognized in the statements of financial position and eliminates current real estate-specific lease guidance, while maintaining substantially similar classification criteria for distinguishing between finance leases and operating leases.	January 2019	The adoption of this standard and related amendments resulted in the recognition of approximately \$15.7 million in right-of-use assets and lease liabilities on our balance sheet as of January 1, 2019. Comparative periods will continue to be measured and presented under historical guidance, and only the period of adoption and future periods will be subject to this ASU. There was no cumulative effect on retained earnings or other components of equity at the adoption date. For more information see Note H.
ASU 2018-02 , Income Statement - Reporting Comprehensive Income (Topic 220)	February 2018	Allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 and requires certain disclosures regarding stranded tax effects in accumulated other comprehensive income.	January 2019	The adoption of this standard did not have a material impact on our consolidated financial statements.

Accounting Pronouncements Not Yet Adopted

Standard	Date of Issuance	Description	Date of Required Adoption	Effect on the Financial Statements
ASU 2016-13 , Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Statements	June 2016	The amendment in this update replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses on instruments within its scope, including trade receivables. This update is intended to provide financial statement users with more decision-useful information about the expected credit losses.	January 2020	We are currently evaluating the impact of the adoption on our consolidated financial statements.

Significant Accounting Policies

Except for the accounting policy for leases that was updated as a result of adopting ASU 2016-02, there were no material changes in our significant accounting policies during the six months ended June 30, 2019. See Note A to the consolidated financial statements included in our Annual Report on Form 10-K/A for the year ended December 31, 2018, as filed with the SEC, for additional information regarding our significant accounting policies.

NOTE B – Business Acquisitions

EDIAdmin

On October 3, 2018, we completed our asset acquisition of EDIAdmin, a privately held company providing end-to-end integration solutions, featuring a dedicated Integration Platform as a Service (“iPaaS”) called Cloud Hybrid Integration Platform (“CHIP”) and collaborative managed services for leading systems and applications, both cloud-based and on-premise. Pursuant to the asset purchase agreement, we paid \$7.5 million in cash to the owner of EDIAdmin. The purchase agreement also allowed the seller to receive up to \$1.7 million in cash, which becomes payable in first quarter 2020 and 2021 contingent upon the completion of certain revenue milestones at December 31, 2019 and December 31, 2020. The fair value of this contingent consideration was \$1.3 million at the date of acquisition and \$1.0 million at June 30, 2019. During the three and six months ended June 30, 2019, we recognized income of \$0.4 million and \$0.3 million, respectively, in our consolidated statements of comprehensive income due to the remeasurement of the contingent liability. See Note E for further disclosures on the remeasurement of the contingent liability.

We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to a trained workforce and other buyer-specific value resulting from expected synergies, including long-term cost savings, which are not included in the fair values of identifiable assets. The purchase accounting for the EDIAdmin acquisition was complete as of December 31, 2018. The consolidated balance sheet as of December 31, 2018 reflects the final allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

CovalentWorks

On December 18, 2018, we completed our asset acquisition of CovalentWorks, a privately held company providing cloud-based EDI solutions to small- and medium-sized businesses. Pursuant to the asset purchase agreement, we paid \$19.4 million in cash and issued \$3.4 million in common stock, or 40,478 shares, to the owners of CovalentWorks.

We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to a trained workforce and other buyer-specific value resulting from expected synergies, including long-term cost savings, which are not included in the fair values of identifiable assets. The purchase accounting, purchase price allocation and net working capital adjustment for the CovalentWorks acquisition were finalized during the first quarter of 2019 and there have been no subsequent adjustments.

NOTE C – Revenue

We derive our revenues primarily from the following revenue streams (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Recurring revenues:				
Fulfillment	\$ 53,694	\$ 46,480	\$ 106,139	\$ 91,844
Analytics	9,245	8,630	18,118	16,889
Other	1,417	1,320	2,845	2,557
Recurring Revenues	64,356	56,430	127,102	111,290
One-time revenues	4,173	4,661	8,361	8,893
	<u>\$ 68,529</u>	<u>\$ 61,091</u>	<u>\$ 135,463</u>	<u>\$ 120,183</u>

Revenues are recognized when our services are made available to our customers, in an amount that reflects the consideration we are contractually and legally entitled to in exchange for those services.

We determine revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, we satisfy a performance obligation

Recurring Revenues

Recurring revenues consists of recurring subscriptions from customers that utilize our Fulfillment, Analytics, and Other cloud-based supply chain management solutions. Revenue for these solutions is generally recognized on a ratable basis over the contract term beginning on the date that our service is made available to the customer. Our contracts with our recurring revenue customers are recurring in nature, ranging from monthly to annual, and generally allow the customer to cancel the contract for any reason with 30 to 90 days' notice. Timing of billings varies by customer and by contract type and are either in advance or within 30 days of the service being performed.

The deferred revenue liability for recurring revenue contracts are for one year or less and recognized on a ratable basis over the contract term. We have applied the optional exemption under Accounting Standards Codification ("ASC") 606-10-50-14(a) and will not disclose information about the remaining performance obligations for contracts which have original durations of one year or less.

One-time Revenues

One-time revenues consist of set-up fees from customers and miscellaneous one-time fees.

Set-up fees are specific for each connection a customer has with a trading partner and many of our customers have connections with numerous trading partners. Set-up fees related to our cloud-based supply chain management solutions are nonrefundable upfront fees that are necessary for our customers to utilize our cloud-based services. These set-up fees do not provide any standalone value to our customers. Except for our Analytics platform, we have determined the set-up fees represent a material renewal option right to our customers as they will not be incurred again upon renewal. These set-up fees and related costs are deferred and recognized ratably over two years, which is the estimated connection life between the customer and the trading partner. For our Analytics platform, we have determined the set-up fees do not represent a material customer renewal right and, as such, are deferred and recognized ratably over the estimated initial contract term, which is one year.

The table below presents the activity of the portion of the deferred revenue liability relating to set-up fees (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Balances, at beginning of period	\$ 9,813	\$ 9,952	\$ 9,857	\$ 10,031
Invoiced set-up fees	2,829	2,530	5,366	5,111
Amortized set-up fees	(2,579)	(2,596)	(5,160)	(5,256)
Balances, at end of period	\$ 10,063	\$ 9,886	\$ 10,063	\$ 9,886

The entire balance of set-up fees will be recognized within two years and, as such, current amounts will be recognized in the next 1-12 months and long-term amounts will be recognized in the next 13-24 months.

Miscellaneous one-time fees consist of professional services and testing and certification. The deferred revenue liability for these one-time fees are for one year or less and recognized at the time service is provided. We have applied the optional exemption under ASC 606-10-50-14(a) and will not disclose information about the remaining performance obligations for contracts which have original durations of one year or less.

NOTE D – Deferred Costs

Deferred costs consist of costs to obtain customer contracts, such as commissions paid to sales personnel and to third-party partners for customer referrals, and costs to fulfill customer contracts, such as customer implementation costs.

Sales commissions relating to recurring revenues are considered incremental and recoverable costs of obtaining a contract with our customer. These commissions are calculated based on estimated annual recurring revenue to be generated over the customer's initial contract year. These costs are deferred and amortized over the expected period of benefit which we have determined to be two years. Amortization expense is included in sales and marketing expenses in the accompanying condensed consolidated statements of operations.

Customer implementation costs are considered incremental and recoverable costs of obtaining a contract with our customer. These costs are deferred and amortized over the expected period of benefit which we have determined to be two years. Amortization expense is included in cost of revenues in the accompanying condensed consolidated statements of operations.

The table below presents the activity of deferred costs and amortization of deferred costs (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Balances, at beginning of period	\$ 45,891	\$ 41,557	\$ 45,475	\$ 39,933
Incurred deferred costs	11,880	11,910	24,212	24,416
Amortized deferred costs	(12,243)	(10,923)	(24,159)	(21,805)
Balances, at end of period	\$ 45,528	\$ 42,544	\$ 45,528	\$ 42,544

NOTE E – Financial Instruments

We invest primarily in money market funds, certificates of deposit, highly liquid debt instruments of the U.S. government and U.S. corporate debt securities. All investments with remaining maturities less than one year from the balance sheet date are classified as short-term investments. Investments with remaining maturities of more than one year from the balance sheet date are classified as long-term investments. As of June 30, 2019 and December 31, 2018, all of our investments held were classified as short-term.

Our short-term marketable securities are classified as available-for-sale. We intend to hold marketable securities until maturity; however, we may sell these securities at any time for use in current operations or for other purposes.

Our marketable securities are carried at fair value and unrealized gains and losses on these investments, net of taxes, are included in accumulated other comprehensive loss in the consolidated balance sheets. Realized gains or losses are included in other income (expense), net in the consolidated statements of comprehensive income. When a determination has been made that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is realized and is included in other income (expense), net in the consolidated statements of comprehensive income.

Cash equivalents and short-term investments consisted of the following (in thousands):

	June 30, 2019		
	Amortized Cost	Unrealized Gains (Losses)	Fair Value
Cash equivalents:			
Money market funds	\$ 119,686	\$ —	\$ 119,686
Certificate of deposit	7,023	—	7,023
Marketable securities:			
Corporate bonds	14,816	(8)	14,808
Commercial paper	14,905	25	14,930
U.S. treasury securities	14,727	163	14,890
Total	\$ 171,157	\$ 180	\$ 171,337

	December 31, 2018		
	Amortized Cost	Unrealized Gains	Fair Value
Cash equivalents:			
Money market funds	\$ 109,265	\$ —	\$ 109,265
Certificate of deposit	7,000	—	7,000
Marketable securities:			
Corporate bonds	15,194	40	15,234
Commercial paper	9,889	76	9,965
U.S. treasury securities	12,300	38	12,338
Total	\$ 153,648	\$ 154	\$ 153,802

We do not believe any of the unrealized losses represent an other-than-temporary impairment based on our valuation of available evidence as of June 30, 2019. We expect to receive the full principal and interest on all of these cash equivalents, certificate of deposit, and marketable securities.

Fair Value Measurements

We measure certain financial assets at fair value on a recurring basis based on a fair value hierarchy that requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs that may be used to measure fair value are:

- Level 1 – quoted prices in active markets for identical assets or liabilities
- Level 2 – observable inputs other than Level 1 prices, such as: (a) quoted prices for similar assets or liabilities, (b) quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or (c) model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities. We obtain the fair values of our level 2 available-for-sale securities from a professional pricing service.
- Level 3 – unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.

For the earn-out liability related to the EDIAdmin acquisition, the Company utilized the Monte Carlo simulation method to estimate the fair value of this contingent liability as of the reporting date. Thousands of iterations of the simulation were performed using forecasted revenues to develop a distribution of future values of recurring revenue which, in turn, provide indicated earn-out payments. The total estimated fair value equals the sum of the average present values of the indicated earn-out payments. Changes in assumptions described above could have an impact on the payout of contingent consideration with a maximum payout being \$1.7 million. The earn-out liability has been measured as Level 3 given the unobservable inputs that are significant to the measurement of the liability.

The following table presents information about our financial assets that are measured at fair value on a recurring basis and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value (in thousands):

	June 30, 2019			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	\$ 119,686	\$ —	\$ —	\$ 119,686
Certificate of deposit	7,023	—	—	7,023
Marketable securities:				
Corporate bonds	—	14,808	—	14,808
Commercial paper	—	14,930	—	14,930
U.S. treasury securities	—	14,890	—	14,890
Total	<u>\$ 126,709</u>	<u>\$ 44,628</u>	<u>\$ —</u>	<u>\$ 171,337</u>
Liabilities:				
Earn-out liability	\$ —	\$ —	\$ 1,024	\$ 1,024
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,024</u>	<u>\$ 1,024</u>

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	\$ 109,265	\$ —	\$ —	\$ 109,265
Certificate of deposit	7,000	—	—	7,000
Marketable securities:				
Corporate bonds	—	15,234	—	15,234
Commercial paper	—	9,965	—	9,965
U.S. treasury securities	—	12,338	—	12,338
Total	<u>\$ 116,265</u>	<u>\$ 37,537</u>	<u>\$ —</u>	<u>\$ 153,802</u>
Liabilities:				
Earn-out liability	\$ —	\$ —	\$ 1,368	\$ 1,368
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,368</u>	<u>\$ 1,368</u>

NOTE F – Goodwill and Intangible Assets, net

The changes in the net carrying amount of goodwill for the six months ended June 30, 2019 are as follows (in thousands):

	2019
Balances, January 1	\$ 69,658
Goodwill acquired during the period	—
Foreign currency translation adjustments	642
Balances, June 30	<u>\$ 70,300</u>

Intangible assets subject to amortization primarily include subscriber relationships, non-competition agreements and acquired technology and are amortized over their respective useful lives (ranging from 1 to 10 years). Intangible assets, net included the following (in thousands):

	June 30, 2019			
	Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net
Subscriber relationships	\$ 42,240	\$ (25,097)	\$ 182	\$ 17,325
Non-competition agreements	2,495	(2,292)	9	212
Technology and other	5,002	(2,169)	9	2,842
	<u>\$ 49,737</u>	<u>\$ (29,558)</u>	<u>\$ 200</u>	<u>\$ 20,379</u>
	December 31, 2018			
	Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net
Subscriber relationships	\$ 43,212	\$ (23,284)	\$ (623)	\$ 19,305
Non-competition agreements	2,560	(2,247)	(28)	285
Technology and other	5,199	(2,012)	(36)	3,151
	<u>\$ 50,971</u>	<u>\$ (27,543)</u>	<u>\$ (687)</u>	<u>\$ 22,741</u>

Total amortization expense for intangible assets was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Amortization expense	\$ 1,266	\$ 1,033	\$ 2,570	\$ 2,158
	\$ 1,266	\$ 1,033	\$ 2,570	\$ 2,158

The estimated annual amortization expense related to intangible assets subject to amortization for the next five years is as follows (in thousands):

Remainder of 2019	\$ 2,540
2020	4,723
2021	3,883
2022	2,779
2023	2,706
Thereafter	3,748
	\$ 20,379

NOTE G – Other Assets

The changes in the net amount of capitalized implementation costs for internal-use software from hosting arrangements for the six months ended June 30, 2019 is as follows (in thousands):

	2019
Balances, January 1	\$ 455
Capitalized implementation fees	517
Amortization of implementation fees	(26)
Balances, June 30	\$ 946

There were no impairment losses in relation to the capitalized implementation costs for the period presented.

NOTE H – Leases

We are obligated under non-cancellable operating leases, primarily for office space and certain equipment as follows (in thousands):

	June 30, 2019	
	Remaining Term (years)	Right-of-Use Asset
Minneapolis, MN lease	6	\$ 10,936
Little Falls, NJ lease	4	1,772
Other leases	1-3	1,330
		\$ 14,038

Some of our leases may include options to extend the leases for up to 5 years. The options to extend our leases are not recognized as part of our ROU assets and lease liabilities as it is not reasonably certain that we will exercise those options. Additionally, our agreements do not include options to terminate the leases.

On December 20, 2017, we executed the fourth amendment to our lease agreement for our current headquarters located in Minneapolis, Minnesota where we lease approximately 189,000 square feet under an agreement that expires on April 30, 2025. We have agreed to expand our headquarters premises by approximately 25,000 square feet during 2020. Our lease agreement also includes a further expansion right and a right of first offer to lease certain additional space and two options to extend the term of the lease for five years at a market rate determined in accordance with the lease. Incentives of \$6.4 million are included as a lease component.

On February 25, 2016, we executed the first amendment to our lease agreement for our Little Falls, New Jersey location where we lease approximately 26,000 square feet under an agreement that expires on June 30, 2023. The agreement includes an option to extend the term of the lease for five years at a market rate determined in accordance with the lease. Incentives of \$0.9 million are included as a lease component.

The components of lease expense were as follows (in thousands):

	<u>Three Months Ended June 30, 2019</u>	<u>Six Months Ended June 30, 2019</u>
Operating lease cost	\$ 620	\$ 1,306
Variable lease cost	835	1,639
	<u>\$ 1,455</u>	<u>\$ 2,945</u>

Operating lease cost for short-term leases was not material for the three and six months ended June 30, 2019.

Supplemental cash flow information related to leases was as follows (in thousands):

	<u>Three Months Ended June 30, 2019</u>	<u>Six Months Ended June 30, 2019</u>
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	1,104	2,137
ROU obtained in exchange for operating lease liabilities	—	—

The ROU assets obtained in exchange for operating lease liabilities excludes the transition amount of \$15.7 million.

Supplemental balance sheet information related to leases was as follows:

	<u>June 30, 2019</u>
Weighted-average remaining lease term - operating leases	5.3 years
Weighted-average discount rate - operating leases	4.5%

At June 30, 2019, our future minimum payments under operating leases were as follows (in thousands):

Remainder of 2019	\$ 2,183
2020	3,648
2021	4,492
2022	4,042
2023	3,855
Thereafter	4,816
	<u>23,036</u>
Less: imputed interest	(2,677)
	<u>\$ 20,359</u>

At December 31, 2018, our future minimum payments under operating leases were as follows (in thousands):

2019	\$	4,209
2020		3,542
2021		4,414
2022		4,042
2023		3,855
Thereafter		4,816
		<u>24,878</u>

NOTE I – Stock-Based Compensation

Our equity compensation plans provide for the grant of incentive and nonqualified stock options, as well as other stock-based awards including restricted stock and restricted stock units (“RSU”), to employees, non-employee directors and other consultants who provide services to us. We also provide an employee stock purchase plan and 401(k) stock match.

Restricted stock awards result in the issuance of new shares when granted. For other stock-based awards, new shares are issued when the award is exercised, vested or released according to the terms of the agreement. In February 2019, 1,040,744 additional shares were reserved for future issuance under our 2010 Equity Incentive Plan. At June 30, 2019, there were approximately 6,162,889 million shares available for grant under approved equity compensation plans.

We recognize stock-based compensation expense on a straight-line basis over the vesting period, except for expense relating to retirement-eligible employees which is recognized immediately upon the employee becoming retirement-eligible.

Stock-based compensation expense was allocated in the condensed consolidated statements of comprehensive income as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Cost of revenues	\$ 662	\$ 504	\$ 1,249	\$ 1,052
Operating expenses				
Sales and marketing	694	710	1,424	1,363
Research and development	602	357	1,125	686
General and administrative	917	1,608	4,371	3,611
Total stock-based compensation expense	<u>\$ 2,875</u>	<u>\$ 3,179</u>	<u>\$ 8,169</u>	<u>\$ 6,712</u>

Stock-based compensation expense by plan type was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Stock options	\$ 655	\$ 739	\$ 1,929	\$ 1,993
Performance share units	151	74	1,074	886
Restricted stock units	1,419	1,829	3,862	2,751
Restricted stock awards	145	135	281	215
Employee stock purchase plan	171	110	361	223
401(k) stock match	334	292	662	644
Total stock-based compensation expense	<u>\$ 2,875</u>	<u>\$ 3,179</u>	<u>\$ 8,169</u>	<u>\$ 6,712</u>

As of June 30, 2019, there was approximately \$20.0 million of unrecognized stock-based compensation expense under our equity compensation plans, which is expected to be recognized on a straight-line basis over a weighted average period of 2.8 years.

Stock Options

Stock options generally vest over four years and have a contractual term of seven to ten years from the date of grant. Our stock option activity was as follows:

	Options (#)	Weighted Average Exercise Price (\$/share)
Outstanding at December 31, 2018	873,234	\$ 51.86
Granted	91,909	107.83
Exercised	(114,480)	41.66
Forfeited	(19,254)	60.25
Outstanding at June 30, 2019	<u>831,409</u>	<u>59.26</u>

Of the total outstanding options at June 30, 2019, 570,649 were exercisable with a weighted average exercise price of \$53.30 per share. The total outstanding options had a weighted average remaining contractual life of 3.32 years.

The weighted average grant date fair value of options granted during the first six months of 2019 was \$33.72. This was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

Volatility	33.2%
Dividend yield	0%
Life (in years)	4.4
Risk-free interest rate	2.41%

Performance Share Units and Restricted Stock Units and Awards

In February 2017, our executive officers were granted performance share unit (“PSU”) awards with vesting contingent on successful attainment of pre-determined revenue targets over the course of a three-year performance period (fiscal years 2017 – 2019). The fair value is measured as the number of performance shares expected to be earned multiplied by the grant date fair value of our shares. The number of performance shares expected to vest during the current service period is estimated and the fair value of those shares is recognized over the remaining service period less any amounts already recognized.

In February 2018 and 2019, our executive officers were granted PSU awards with vesting contingent on the Company’s total shareholder return as compared to indexed total shareholder return over the course of a three-year performance period (fiscal years 2018 – 2020 and fiscal years 2019 – 2021, respectively). The grant date fair value was estimated using a Monte Carlo simulation that utilizes multiple input variables that determine the probability of satisfying the performance conditions stipulated in the award and calculates the fair market value for the PSUs granted. Expense is recognized on a straight-line basis over the vesting period, regardless of whether the market condition is satisfied.

RSUs vest over four years and, upon vesting, the holder is entitled to receive shares of our common stock. With restricted stock awards, shares of our common stock are issued when the award is granted and the restrictions lapse over one year.

Activity for our PSUs and restricted stock units was as follows:

	PSUs and RSUs (#)	Weighted Average Grant Date Fair Value (\$/share)
Outstanding at December 31, 2018	377,335	\$ 59.90
Granted	98,203	112.46
Vested and common stock issued	(95,312)	57.53
Forfeited	(11,460)	61.41
Outstanding at June 30, 2019	<u>368,766</u>	<u>74.46</u>

The number of restricted stock units outstanding at June 30, 2019 included 25,617 units that have vested, but for which shares of common stock have not yet been issued pursuant to the terms of the agreement.

Our restricted stock awards activity was as follows:

	Restricted Stock Awards (#)	Weighted Average Grant Date Fair Value (\$/share)
Outstanding at December 31, 2018	1,832	\$ 74.44
Restricted common stock issued	4,920	103.60
Restrictions lapsed	(3,062)	86.15
Forfeited	—	—
Outstanding at June 30, 2019	<u>3,690</u>	<u>103.60</u>

Employee Stock Purchase Plan

We have an employee stock purchase plan which allows participating employees to purchase shares of our common stock at a discount through payroll deductions. The plan is available to all employees subject to certain eligibility requirements. Participating employees may purchase common stock, on a voluntary after tax basis, at a price that is the lower of 85% of the fair market value of one share of common stock at the beginning or end of each stock purchase period. The plan consists of two six-month offering periods, beginning on January 1 and July 1 of each calendar year, respectively. A total of 1.0 million shares of common stock are reserved for issuance under the plan.

For the offering periods that began on January 1, 2019 and January 1, 2018, we withheld approximately \$1.2 million and \$0.8 million from employees participating in the plan for the six months ended June 30, 2019 and 2018, respectively.

The fair value was estimated based on the market price of our common stock at the beginning of the offering period using the Black-Scholes option pricing model with the following assumptions:

Volatility	40%
Dividend yield	0%
Life (in years)	0.5
Risk-free interest rate	2.56%

401(k) Stock Match

We sponsor a 401(k) retirement savings plan for our U.S. employees where employees can contribute up to 80% of their compensation, subject to the limits established by law. We match 50% of the employee's elective deferrals, up to the first 6% of the employee's pre-tax compensation for each pay period. A portion of our match is in company stock, which is purchased from the open market by our plan provider and immediately deposited into the employee's 401(k) account.

NOTE J – Income Taxes

We record our interim provision for income taxes by applying our estimated annual effective tax rate to our year-to-date pretax income and adjust the provision for discrete tax items recorded in the period. Differences between our effective tax rate and statutory tax rates are primarily due to the impact of permanently non-deductible expenses partially offset by the federal research and development credits. Additionally, excess tax benefits generated upon settlement or exercise of stock awards are recognized as a reduction to income tax expense as a discrete tax item in the quarter that the event occurs creating potentially significant fluctuation in tax expense by quarter and by year. Our provisions for income taxes include current foreign and state income tax expense, as well as deferred tax expense.

As of June 30, 2019 we do not have any unrecognized tax benefits nor any accrued interest or tax penalties.

NOTE K – Net Income Per Share

Basic net income per share has been computed using the weighted average number of shares of common stock outstanding during each period. Diluted net income per share also includes the impact of our outstanding potential common shares, including options and restricted stock units. Potential common shares that are anti-dilutive are excluded from the calculation of diluted net income per share.

The following table presents the components of the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Numerator				
Net income	\$ 8,796	\$ 5,416	\$ 15,609	\$ 8,670
Denominator				
Weighted average common shares outstanding, basic	17,505	17,163	17,488	17,140
Options to purchase common stock	349	290	357	225
Restricted stock units	156	91	158	77
Employee stock purchase plan	—	5	—	4
Weighted average common shares outstanding, diluted	18,010	17,549	18,003	17,446
Net income per share				
Basic	\$ 0.50	\$ 0.32	\$ 0.89	\$ 0.51
Diluted	\$ 0.49	\$ 0.31	\$ 0.87	\$ 0.50
Antidilutive shares (in thousands)	74	53	91	264

NOTE L – Subsequent Event

On July 25, 2019, the Company's board of directors declared a two-for-one stock split of the Company's common stock, which will be effected in the form of a 100 percent share dividend, and will be distributed August 22, 2019, to shareholders of record as of August 8, 2019. The stock split will increase the number of shares outstanding from approximately 18.1 million shares to approximately 36.2 million shares.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

SPS Commerce is a leading provider of cloud-based solutions that make it easier for retailers, suppliers, grocers, distributors and logistics firms to orchestrate the management of item data, order fulfillment, inventory control and sales analytics across all channels. The solutions offered by SPS Commerce eliminate the need for on-premise software and support staff by taking on that capability on the customer’s behalf. We derive the majority of our revenues from numerous monthly recurring subscriptions from businesses that utilize our solutions.

We plan to continue to grow our business by further penetrating the supply chain management market, increasing revenues from our customers as their businesses grow, expanding our distribution channels, expanding our international presence and, from time to time, developing new solutions and applications. We also intend to selectively pursue acquisitions that will add customers, allow us to expand into new regions, or allow us to offer new functionalities.

For the three months ended June 30, 2019, our revenues were \$68.5 million, an increase of 12% from the comparable period in 2018, and represented our 74th consecutive quarter of increased revenues. Total operating expenses increased 2% for the same period in 2019 from 2018. For the six months ended June 30, 2019, revenues increased 13% and operating expenses increased 6% compared to the same period in 2018.

Key Financial Terms and Metrics

We have several key financial terms and metrics, including annualized average recurring revenues per recurring revenue customer, which we also refer to as wallet share. During the three and six months ended June 30, 2019, there were no changes in the definitions of our key financial terms and metrics, which are discussed in more detail under the heading “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*” included in our Annual Report on Form 10-K/A for the year ended December 31, 2018 as filed with the SEC.

To supplement our financial statements, we also provide investors with Adjusted EBITDA and non-GAAP income per share, both of which are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare the company’s performance to that of prior periods for trend analyses and planning purposes. Adjusted EBITDA is also used for purposes of determining executive and senior management incentive compensation. These measures are presented to our board of directors.

These non-GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP. These non-GAAP financial measures exclude significant expenses and income that are required by GAAP to be recorded in our financial statements and are subject to inherent limitations. Investors should review the reconciliations of non-GAAP financial measures to the comparable GAAP financial measures that are included in this “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*.”

Critical Accounting Policies and Estimates

This discussion of our financial condition and results of operations is based upon our condensed consolidated financial statements, which are prepared in accordance with GAAP and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable. Our actual results may differ from these estimates under different assumptions or conditions.

A critical accounting policy is one that is both material to the presentation of our financial statements and requires us to make difficult, subjective or complex judgments relating to uncertain matters that could have a material effect on our financial condition and results of operations. Accordingly, we believe that our policies for revenue recognition and income taxes are the most critical to fully understand and evaluate our financial condition and results of operations.

During the three and six months ended June 30, 2019, there were no changes in our critical accounting policies or estimates, other than the adoption of ASU No. 2016-02. See Note A to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K/A for the year ended December 31, 2018, as filed with the SEC, for additional information regarding our accounting policies.

Results of Operations

Three months ended June 30, 2019 compared to three months ended June 30, 2018

The following table presents our results of operations for the periods indicated (dollars in thousands):

	Three Months Ended June 30,				Change	
	2019		2018		\$	%
		% of revenue		% of revenue		
Revenues	\$ 68,529	100.0%	\$ 61,091	100.0%	\$ 7,438	12.2%
Cost of revenues	23,700	34.6	20,402	33.4	3,298	16.2
Gross profit	44,829	65.4	40,689	66.6	4,140	10.2
Operating expenses						
Sales and marketing	17,545	25.6	18,424	30.1	(879)	(4.8)
Research and development	6,509	9.5	5,293	8.7	1,216	23.0
General and administrative	10,179	14.9	9,974	16.3	205	2.1
Amortization of intangible assets	1,266	1.8	1,033	1.7	233	22.6
Total operating expenses	35,499	51.8	34,724	56.8	775	2.2
Income from operations	9,330	13.6	5,965	9.8	3,365	56.4
Other income (expense)						
Interest income, net	813	1.2	547	0.9	266	48.6
Other expense, net	240	0.4	(168)	(0.3)	408	242.9
Change in earn-out liability	400	0.6	—	0.0	400	100.0
Total other income, net	1,453	2.1	379	0.6	1,074	283.4
Income before income taxes	10,783	15.7	6,344	10.4	4,439	70.0
Income tax expense	1,987	2.9	928	1.5	1,059	114.1
Net income	\$ 8,796	12.8%	\$ 5,416	8.9%	\$ 3,380	62.4%

Revenues. The increase in revenues resulted from two primary factors: the increase in recurring revenue customers and the increase in annualized average recurring revenues per recurring revenue customer, which we also refer to as wallet share.

- The number of recurring revenue customers increased 14% to 29,889 at June 30, 2019 from 26,212 at June 30, 2018.
- Annualized average recurring revenues per recurring revenue customer, or wallet share, stayed level at \$8,674 for the three months ended June 30, 2019 from \$8,665 for the same period in 2018. The consistent wallet share is due to the increase in recurring revenue customers.

Recurring revenues from recurring revenue customers accounted for 94% of our total revenues for the three months ended June 30, 2019, increasing from 92% for the same period in 2018. We anticipate that the number of recurring revenue customers and wallet share will continue to increase as we increase the number of solutions we offer and increase the penetration of those solutions across our customer base.

Cost of Revenues. The increase in cost of revenues for the three months ended June 30, 2019 was primarily due to an increase in personnel-related costs of \$2.5 million, driven by increased salaries and benefits due to business growth and by increased consulting and contract labor. As we continued to invest in the infrastructure supporting our platform, depreciation expense increased by \$0.5 million compared to the same period in 2018.

Sales and Marketing Expenses. The decrease in sales and marketing expenses for the three months ended June 30, 2019 was primarily due to decreased headcount, which resulted in a decrease of \$0.5 million in salaries and benefits, compared to the same period in 2018.

Research and Development Expenses. The increase in research and development expense for the three months ended June 30, 2019 was primarily due to increased headcount which resulted in an increase in personnel costs of \$0.8 million and an increase in stock-based compensation expense of \$0.2 million.

General and Administrative Expenses. The increase in general and administrative expenses for the three months ended June 30, 2019 was a result of continued business growth which drove an increase in personnel-related costs of \$0.5 million, an increase of \$0.3 million in cloud-based and software subscriptions, and an increase of \$0.3 million in bad debt expense. The increases in these costs were offset by a decrease in stock-based compensation of \$0.7 million driven by the timing of the Chief Executive Officer's 2019 RSU grants compared to his 2018 RSU grants.

Other Income (Expense). Interest income, net, other expense, net, and change in earn-out liability for the three months ended June 30, 2019 increased over the same period in 2018 primarily due to increased interest income from investments, offset by realized foreign currency exchange gains, and decrease in the fair value of the earn-out liability. The change in fair value of the earn-out liability for the three months ended June 30, 2019 of \$0.4 million in income was driven by an adjustment to the fair value of the EDIAdmin earnout liability due to estimated revenue at the earn-out measurement dates, December 31, 2019 and December 31, 2020.

Income Tax Expense. The increase in income tax expense for the three months ended June 30, 2019 was primarily due to an increase in pre-tax income. Under ASU 2016-09, excess tax benefits generated upon the settlement or exercise of stock awards are recognized as a reduction to income tax expense and, as a result, we expect that our annual effective income tax rate will be volatile.

Adjusted EBITDA. Adjusted EBITDA, which is a non-GAAP measure of financial performance, consists of net income adjusted for depreciation and amortization, interest expense, interest income, income tax expense, stock-based compensation expense, the discrete impact from tax law change, and other adjustments as necessary for a fair presentation. Other adjustments included the impact of the fair value adjustment for the EDIAdmin earn-out liability. The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

	Three Months Ended June 30,	
	2019	2018
Net income	\$ 8,796	\$ 5,416
Depreciation and amortization of property and equipment	2,688	2,093
Amortization of intangible assets	1,266	1,033
Interest income, net	(813)	(547)
Income tax expense	1,987	928
Stock-based compensation expense	2,875	3,179
Other	(400)	—
Adjusted EBITDA	<u>\$ 16,399</u>	<u>\$ 12,102</u>

Non-GAAP Income per Share. Non-GAAP income per share, which is also a non-GAAP measure of financial performance, consists of net income plus stock-based compensation expense, amortization expense related to intangible assets, the discrete impact from tax law change and other adjustments as necessary for a fair presentation, divided by the weighted average number of shares of common stock outstanding during each period. Other adjustments included the impact of the fair value adjustment for the EDIAdmin earn-out liability. The following table provides a reconciliation of net income to non-GAAP income per share (in thousands, except per share amounts):

	Three Months Ended June 30,	
	2019	2018
Net income	\$ 8,796	\$ 5,416
Stock-based compensation expense	2,875	3,179
Amortization of intangible assets	1,266	1,033
Other	(400)	—
Income tax effects of adjustments	(1,723)	(1,027)
Non-GAAP income	<u>\$ 10,814</u>	<u>\$ 8,601</u>
Shares used to compute non-GAAP income per share		
Basic	17,505	17,163
Diluted	18,010	17,549
Non-GAAP income per share		
Basic	\$ 0.62	\$ 0.50
Diluted	\$ 0.60	\$ 0.49

The following table presents our results of operations for the periods indicated (dollars in thousands):

	Six Months Ended June 30,				Change	
	2019		2018		\$	%
		% of revenue		% of revenue		
Revenues	\$ 135,463	100.0%	\$ 120,183	100.0%	\$ 15,280	12.7%
Cost of revenues	45,067	33.3	40,160	33.4	4,907	12.2
Gross profit	90,396	66.7	80,023	66.6	10,373	13.0
Operating expenses						
Sales and marketing	35,467	26.2	37,071	30.8	(1,604)	(4.3)
Research and development	12,701	9.4	10,425	8.7	2,276	21.8
General and administrative	22,949	16.9	20,104	16.7	2,845	14.2
Amortization of intangible assets	2,570	1.9	2,158	1.8	412	19.1
Total operating expenses	73,687	54.4	69,758	58.0	3,929	5.6
Income from operations	16,709	12.3	10,265	8.5	6,444	62.8
Other income (expense)						
Interest income, net	1,390	1.0	961	0.8	429	44.6
Other income (expense), net	193	0.1	(322)	(0.3)	515	159.9
Change in earn-out liability	344	0.3	—	—	344	100.0
Total other income (expense), net	1,927	1.4	639	0.5	1,288	201.6
Income before income taxes	18,636	13.8	10,904	9.1	7,732	70.9
Income tax expense	3,027	2.2	2,234	1.9	793	35.5
Net income	\$ 15,609	11.5%	\$ 8,670	7.2%	\$ 6,939	80.0%

Revenues. Revenues for the six months ended June 30, 2019 increased \$15.3 million, or 13%, to \$135.5 million from \$120.2 million for the same period in 2018. The increase in revenues resulted from two primary factors: the increase in recurring revenue customers and the increase in annualized average recurring revenues per recurring revenue customer, which we also refer to as wallet share.

- The number of recurring revenue customers increased 14% to 29,889 at June 30, 2019 from 26,212 at June 30, 2018.
- Annualized average recurring revenues per recurring revenue customer, or wallet share, stayed level at \$8,588 for the six months ended June 30, 2019 from \$8,567 for the same period in 2018. The consistent wallet share is due to the increase in recurring revenue customers.

Recurring revenues from recurring revenue customers accounted for 94% of our total revenues for the six months ended June 30, 2019, increasing from 93% for the same period in 2018. We anticipate that the number of recurring revenue customers and wallet share will continue to increase as we increase the number of solutions we offer and increase the penetration of those solutions across our customer base.

Cost of Revenues. The increase in cost of revenues for the six months ended June 30, 2019 was primarily due to an increase of \$3.5 million in personnel-related costs, driven by continued business growth and by an increase in contractor labor. As we continued to invest in the infrastructure supporting our platform, depreciation expense increased by \$1.0 million compared to the same period in 2018.

Sales and Marketing Expenses. The decrease in sales and marketing expenses for the six months ended June 30, 2019 was due to a decrease of \$2.1 million of personnel-related costs, offset by a \$0.3 million increase in variable compensation earned by sales personnel and referral partners, as a result of new business.

Research and Development Expenses. The increase in research and development expenses for the six months ended June 30, 2019 was primarily due to increased headcount which resulted in an increase in personnel costs of \$1.6 million and an increase of stock-based compensation of \$0.4 million.

General and Administrative Expenses. The increase in general and administrative expenses for the six months ended June 30, 2019 was a result of continued business growth driven by an increase in personnel-related costs of \$1.0 million and an increase in stock-based compensation of \$0.8 million. Additionally, other expenses increased by \$1.2 million, primarily driven by increased costs of software subscriptions, credit card fees and bad debt expense.

Other Income (Expense), net. Interest income, net, other expense, net, and change in earn-out liability for the six months ended June 30, 2019 increased over the same period in 2018 primarily due to increased income from investments and settlement and subsequent return of escrowed shares from the Toolbox acquisition, offset by realized foreign currency exchange gains, and decrease in fair value of the earn-out liability. The change in earn-out liability for the six months ended June 30, 2019 was \$0.3 million in income driven by an adjustment to the fair value of the EDIAdmin earnout liability due to estimated revenue at the earn-out measurement dates, December 31, 2019 and December 31, 2020.

Income Tax Expense. The increase in income tax expense for the six months ended June 30, 2019, as compared to the same period in 2018, was primarily due to an increase in pre-tax income, partially offset by an increase of \$1.2 million in discrete tax benefits, primarily driven by an increase in stock activity. Under ASU 2016-09, excess tax benefits generated upon the settlement or exercise of stock awards are recognized as a reduction to income tax expense and, as a result, we expect that our annual effective income tax rate will be volatile.

Adjusted EBITDA. Adjusted EBITDA, which is a non-GAAP measure of financial performance, consists of net income adjusted for depreciation and amortization, interest expense, interest income, income tax expense, stock-based compensation expense, the discrete impact from tax law change, and other adjustments as necessary for a fair presentation. Other adjustments included the impact of the fair value adjustment for the EDIAdmin earn-out liability, returned escrow shares related to the Toolbox acquisition, and an impairment of internally developed software. The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

	Six Months Ended June 30,	
	2019	2018
Net income	\$ 15,609	\$ 8,670
Depreciation and amortization of property and equipment	5,324	4,176
Amortization of intangible assets	2,570	2,158
Interest income, net	(1,390)	(961)
Income tax expense	3,027	2,234
Stock-based compensation expense	8,169	6,712
Other	(461)	—
Adjusted EBITDA	<u>\$ 32,848</u>	<u>\$ 22,989</u>

Non-GAAP Income per Share. Non-GAAP income per share, which is also a non-GAAP measure of financial performance, consists of net income plus stock-based compensation expense, amortization expense related to intangible assets, the discrete impact from tax law change and other adjustments as necessary for a fair presentation, divided by the weighted average number of shares of common stock outstanding during each period. Other adjustments included the impact of the fair value adjustment for the EDIAdmin earn-out liability, returned escrow shares related to the Toolbox acquisition, and an impairment of internally developed software. The following table provides a reconciliation of net income to Non-GAAP income per share (in thousands, except per share amounts):

	Six Months Ended June 30,	
	2019	2018
Net income	\$ 15,609	\$ 8,670
Stock-based compensation expense	8,169	6,712
Amortization of intangible assets	2,570	2,158
Other	(461)	—
Income tax effects of adjustments	(4,366)	(2,180)
Non-GAAP income	<u>\$ 21,521</u>	<u>\$ 15,360</u>
Shares used to compute non-GAAP income per share		
Basic	17,488	17,140
Diluted	18,003	17,446
Non-GAAP income per share		
Basic	\$ 1.23	\$ 0.90
Diluted	\$ 1.20	\$ 0.88

Liquidity and Capital Resources

At June 30, 2019, our principal sources of liquidity were cash, cash equivalents, certificates of deposit and marketable securities of \$198.7 million and accounts receivable, net of allowance for doubtful accounts of \$30.7 million. Certificates of deposit and marketable securities are invested in accordance with our investment policy, with a goal of maintaining liquidity and capital preservation. Our cash equivalents and marketable securities are held in highly liquid money market funds, commercial paper, federal agency securities and corporate debt securities.

The below table summarizes the activity within the statement of cash flows:

	Six Months Ended June 30,	
	2019	2018
Net cash provided by operating activities	\$ 29,662	\$ 22,247
Net cash used in investing activities	(12,174)	(13,978)
Net cash used in financing activities	(4,516)	(5,913)

Net Cash Flows from Operating Activities

The increase in operating cash flows as compared to the same period in 2018 was primarily due to increased net income, stock-based compensation, depreciation and amortization of property and equipment, and deferred costs, offset by decreases in accrued compensation related to timing of payroll and deferred rent due to the adoption of ASC 842, *Leases*.

Net Cash Flows from Investing Activities

The change in net cash used in investing activities compared to the same period in 2018 was primarily due to capital purchases in investments in excess of expenditures and maturities of investments. For the six months ended June 30, 2019, investments purchased, net of maturities, of \$6.8 million and capital expenditures of \$5.4 million compared to net purchases of \$7.1 million and capital expenditures of \$6.5 million in the six months ended June 30, 2018. Our capital expenditures are for supporting our business growth and existing customer base, as well as for our internal use such as equipment for our employees.

Net Cash Flows from Financing Activities

The change in net cash used in financing activities as compared to the same period in 2018 was primarily due to the decrease in net proceeds from stock option exercises and decrease in cash used for share repurchases.

Effect of Foreign Currency Exchange Rate Changes

Our results of operations and cash flows were not materially affected by fluctuations in foreign currency exchange rates. We maintain approximately 6% of our total cash and cash equivalents outside of the U.S. in foreign currencies, primarily in Australian and Canadian dollars. We believe that a significant change in foreign currency exchange rates or an inability to access these funds would not affect our ability to meet our operational needs.

Adequacy of Capital Resources

Our future capital requirements may vary significantly from those now planned and will depend on many factors, including:

- costs to develop and implement new solutions and applications, if any;
- sales and marketing resources needed to further penetrate our market and gain acceptance of new solutions and applications that we may develop;
- expansion of our operations in the United States and internationally;
- response of competitors to our solutions and applications; and,
- use of capital for acquisitions, if any.

Historically, we have experienced increases in our expenditures consistent with the growth in our operations, and we anticipate that our expenditures will continue to increase as we expand our business.

We believe our cash, cash equivalents, certificates of deposit, marketable securities and our cash flows from operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months.

Inflation and changing prices did not have a material effect on our business during the six months ended June 30, 2019 and we do not expect that inflation or changing prices will materially affect our business in the foreseeable future.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts or synthetic leases.

Contractual and Commercial Commitment Summary

Our contractual obligations and commercial commitments as of June 30, 2019 are summarized below:

Contractual Obligations	Payments Due By Period (in thousands)				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating lease obligations, including imputed interest	\$ 23,036	\$ 2,183	\$ 8,140	\$ 7,897	\$ 4,816

Our contractual obligations and commercial commitments as of December 31, 2018 are summarized below:

Contractual Obligations	Payments Due By Period (in thousands)				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating lease obligations, including imputed interest	\$ 24,878	\$ 4,209	\$ 7,956	\$ 7,896	\$ 4,817

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity Risk

The principal objectives of our investment activities are to preserve principal, provide liquidity and maximize income consistent with minimizing risk of material loss. We are exposed to market risk related to changes in interest rates. However, based on the nature and current level of our investments (primarily cash and cash equivalents, which approximate fair value due to their short maturities, certificates of deposit and marketable securities), we believe there is no material risk exposure. We do not enter into investments for trading or speculative purposes.

We did not have any outstanding debt as of June 30, 2019. Therefore, we do not have any material risk to interest rate fluctuations.

Foreign Currency Exchange Risk

We have revenue, expenses, assets and liabilities that are denominated in currencies other than the U.S. dollar, primarily the Australian dollar and Canadian dollar. As of June 30, 2019, we maintained approximately 6% of our total cash and cash equivalents outside of the U.S. in foreign currencies. We believe that a significant change in foreign currency exchange rates or an inability to access these funds would not affect our ability to meet our operational needs. As we expand internationally, our results of operations and cash flows may be impacted by changes in foreign currency exchange rates, and would be adversely impacted when the U.S. dollar appreciates relative to other foreign currencies. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency exchange risk, although we may do so in the future.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2019.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

In the fourth quarter of 2018, we acquired the assets of two separate entities, EDIAdmin and CovalentWorks. EDIAdmin and CovalentWorks represented approximately two percent and six percent of our total consolidated assets, respectively. EDIAdmin and CovalentWorks each represented less than one percent of our consolidated revenues as of and for the year ended December 31, 2018. As these acquisitions occurred in 2018, the scope of our assessment of the effectiveness of internal control over financial reporting does not include EDIAdmin and CovalentWorks. This exclusion is in accordance with the SEC's general guidance that an assessment of a recently acquired business may be omitted from the assessment of the effectiveness of internal control over financial reporting in the year following acquisition.

PART II. – OTHER INFORMATION

Item 1. Legal Proceedings

We are not currently subject to any material legal proceedings. From time to time, we may be named as a defendant in legal actions or otherwise be subject to claims arising from our normal business activities. Any such actions, even those that lack merit, could result in the expenditure of significant financial and managerial resources. We believe that we have obtained adequate insurance coverage or rights to indemnification in connection with potential legal proceedings that may arise.

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed under the heading “*Risk Factors*” in our Annual Report on Form 10-K/A for the year ended December 31, 2018 as filed with the SEC.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Share Repurchases

The following table presents the total number of shares of our common stock that we purchased during the second quarter of 2019, the average price paid per share, the number of shares that we purchased as part of our publicly announced repurchase program and the approximate dollar value of shares that still could be repurchased at the end of the applicable period.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program (1)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program (1)
April 1 - 30, 2019	52,563	\$ 103.11	52,563	\$ 15,935,000
May 1 - 31, 2019	5,552	\$ 104.47	5,552	\$ 15,355,000
June 1 - 30, 2019	—	—	—	15,355,000
Total second quarter 2019	<u>58,115</u>	\$ 103.24	<u>58,115</u>	\$ 15,355,000

(1) Pursuant to a \$50.0 million share repurchase program that was announced by our board of directors on November 2, 2017. Under the program, purchases may be made from time to time in the open market through November 2, 2019.

Item 3. Defaults Upon Senior Securities

Not Applicable.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

Not Applicable.

Item 6. Exhibits

<u>Number</u>	<u>Description</u>
3.1	<u>Certificate of Incorporation (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-3 (File No. 333-182097) filed with the Commission on September 13, 2012).</u>
3.2	<u>Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K (File No. 001-34702) filed with the Commission on October 12, 2017).</u>
31.1	<u>Certification of Principal Executive Officer pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
31.2	<u>Certification of Principal Financial Officer pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934, as amended (filed herewith).</u>
32.1	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).</u>
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T (filed herewith). The XBRL instance document does not appear in the Interactive Data File because its tags are embedded within the Inline XBRL document.

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.

Dated: July 26, 2019

SPS COMMERCE, INC.

/s/ KIMBERLY K. NELSON

Kimberly K. Nelson

Executive Vice President and Chief Financial Officer
(principal financial and accounting officer)

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT

I, Archie C. Black, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SPS Commerce, 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.

/s/ ARCHIE C. BLACK

Archie C. Black

President and Chief Executive Officer

(principal executive officer)

July 26, 2019

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT

I, Kimberly K. Nelson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of SPS Commerce, 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.

/s/ KIMBERLY K. NELSON

Kimberly K. Nelson

*Executive Vice President and Chief Financial Officer
(principal financial and accounting officer)*

July 26, 2019

**CERTIFICATION PURSUANT TO
18 U.S.C. §1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of SPS Commerce, Inc. (the "Company") for the period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Chief Executive Officer and the Chief Financial Officer of the Company, hereby certify, pursuant to and for purposes of 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ARCHIE C. BLACK

Archie C. Black

President and Chief Executive Officer

(principal executive officer)

/s/ KIMBERLY K. NELSON

Kimberly K. Nelson

Executive Vice President and Chief Financial Officer

(principal financial and accounting officer)

July 26, 2019