MINDBODY, Inc.
Form 10-Q
November 01, 2017

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

or

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

For the transition period from __________ to __________.

Commission File Number: 001-37453

MINDBODY, INC.
(Exact name of registrant as specified in its charter)

Delaware	20-1898451
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4051 Broad Street, Suite 220
San Luis Obispo, CA 93401
(Address of principal executive offices)(Zip Code)
(877) 755-4279
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a small reporting company)	Small reporting company	o
		Emerging growth company	x

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. x

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

As of October 27, 2017, the registrant had 42,725,530 shares of Class A common stock, and 3,975,840 shares of Class B common stock outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “ “possible,” “continue” or the negative of these words or other similar terms or expressions that concern, among other things, our expectations, strategy, plans or intentions. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, results of operations and prospects. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our ability to attract and retain subscribers, including high value subscribers;
- our ability to deepen our relationships with existing subscribers;
- our business plan and beliefs and objectives for future operations, including regarding our pricing and pricing model;
- benefits associated with use of our products and services;
- our ability to develop or acquire new products and services, improve our existing products and services and increase the value of our products and services;
- the network effects associated with our business;
- our ability to increase our revenue or maintain our revenue growth rate;
- our future financial performance, including expectations regarding trends in revenue, cost of revenue, operating expenses, other income and expenses, income taxes, subscriber growth, average monthly revenue per subscriber, payments volume, and dollar-based net expansion rate;
- our ability to further develop strategic relationships, including our ability to increase our revenue from our API and technology partners;
- our ability to strengthen and maintain our partnerships with our payment processors;
- our ability to achieve positive returns on investments;
- our plans to further invest in and grow our business, including investment in research and development, sales and marketing, the development of our customer support teams, and our data center infrastructure, and our ability to effectively manage our growth and associated investments;
- our ability to timely and effectively scale and adapt our existing technology;
- the effects of the evolving regulatory framework for privacy, security, and data protection on our platform;
- the sufficiency of our cash and cash equivalents and cash generated from operations to meet our working capital and capital expenditure requirements;
- the effects of seasonal trends on our operating results;
- our ability to attract and retain senior management, qualified employees and key personnel;
- our ability to successfully identify, acquire and integrate companies and assets;
- our ability to successfully enter new vertical and geographic markets and manage our international expansion; and
- our ability to maintain, protect and enhance our intellectual property and not infringe upon others’ intellectual property.

We caution you that the foregoing list may not contain all of the forward-looking statements made in this Quarterly Report on Form 10-Q. You should not rely upon forward-looking statements as predictions of future events. The outcomes of the events described in these forward-looking statements are subject to substantial risks, uncertainties and other factors described in Part II, Item 1A - “Risk Factors,” and elsewhere, in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. We cannot assure you that the results, events and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events or circumstances could differ materially from those described in the forward-looking statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make.

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PART I—FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)
MINDBODY, INC.
Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)
(Unaudited)

	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$225,312	$85,864
Accounts receivable	10,047	9,129
Prepaid expenses and other current assets	5,698	3,702
Total current assets	241,057	98,695
Property and equipment, net	34,484	33,104
Intangible assets, net	5,835	2,027
Goodwill	11,583	9,039
Other noncurrent assets	593	650
TOTAL ASSETS	$293,552	$143,515
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$7,421	$4,827
Accrued expenses and other liabilities	10,857	10,470
Deferred revenue, current portion	6,063	4,859
Other current liabilities	1,871	581
Total current liabilities	26,212	20,737
Deferred revenue, noncurrent portion	3,256	3,269
Deferred rent, noncurrent portion	1,811	1,387
Financing obligation on leases, noncurrent portion	15,066	15,450
Other noncurrent liabilities	689	1,016
Total liabilities	47,034	41,859
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Class A common stock, par value of $0.000004 per share; 1,000,000,000 shares authorized, 42,583,388 shares issued and outstanding as of September 30, 2017; 1,000,000,000 shares authorized, 30,820,502 shares issued and outstanding as of December 31, 2016	—	—
Class B common stock, par value of $0.000004 per share; 100,000,000 shares authorized, 4,002,891 shares issued and outstanding as of September 30, 2017; 100,000,000 shares authorized, 9,777,757 shares issued and outstanding as of December 31, 2016	—	—
Additional paid-in capital	445,928	289,317
Accumulated other comprehensive loss	(135)	(300)
Accumulated deficit	(199,275)	(187,361)
Total stockholders' equity	246,518	101,656
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$293,552	$143,515

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

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MINDBODY, INC.
Condensed Consolidated Statements of Operations
(in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenue	$46,612	$35,262	$132,933	$100,830
Cost of revenue	13,123	10,972	37,880	31,657
Gross profit	33,489	24,290	95,053	69,173
Operating expenses:				
Sales and marketing	18,514	14,599	52,210	41,534
Research and development	8,976	7,747	26,426	22,758
General and administrative	9,763	7,346	27,807	22,550
Total operating expenses	37,253	29,692	106,443	86,842
Loss from operations	(3,764)	(5,402)	(11,390)	(17,669)
Interest income (expense), net	172	(261)	(125)	(865)
Other income (expense), net	45	(90)	(56)	(226)
Loss before provision for income taxes	(3,547)	(5,753)	(11,571)	(18,760)
Provision for income taxes	83	142	343	279
Net loss	(3,630)	(5,895)	(11,914)	(19,039)
Net loss per share, basic and diluted	$(0.08)	$(0.15)	$(0.27)	$(0.48)
Weighted-average shares used to compute net loss per share, basic and diluted	46,460	39,965	43,475	39,708

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

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MINDBODY, INC.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net loss	$(3,630)	$(5,895)	$(11,914)	$(19,039)
Other comprehensive gain (loss), net of taxes:				
Change in cumulative translation adjustment	22	(6)	165	24
Comprehensive loss	$(3,608)	$(5,901)	$(11,749)	$(19,015)

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

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MINDBODY, INC.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(11,914)	$(19,039)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,736	5,671
Stock-based compensation expense	9,925	6,606
Other	17	820
Changes in operating assets and liabilities net of effects of acquisitions:		
Accounts receivable	(839)	(2,229)
Prepaid expenses and other current assets	(1,961)	(605)
Other assets	64	(67)
Accounts payable	1,661	(52)
Accrued expenses and other liabilities	265	2,635
Deferred revenue	1,152	2,031
Deferred rent	418	105
Net cash provided by (used in) operating activities	5,524	(4,124)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(5,792)	(6,466)
Acquisition of business	(1,700)	(4,138)
Net cash used in investing activities	(7,492)	(10,604)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from follow-on public offering	134,277	—
Proceeds from employee stock purchase plan	3,238	3,040
Proceeds from exercise of equity awards	5,619	4,884
Payment related to shares withheld for taxes	(1,563)	—
Repayment on financing and capital lease obligations	(321)	(287)
Other	(33)	(33)
Net cash provided by financing activities	141,217	7,604
Effect of exchange rate changes on cash and cash equivalents	199	7
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	139,448	(7,117)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	85,864	93,405
CASH AND CASH EQUIVALENTS, END OF PERIOD	$225,312	$86,288
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for income taxes	$212	$186
Cash paid for interest	934	980
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Earnout in business combination deemed part of total purchase consideration	5,142	—
Unpaid equipment purchases	1,664	1,592
Unpaid acquisition consideration held back to satisfy potential indemnification claims	500	750
Unpaid follow-on public offering costs	11	—
Stock issued in business acquisition	—	500

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

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MINDBODY, INC.
Notes to Condensed Consolidated Financial Statements

1. SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES
Description of Business
MINDBODY, Inc. (“MINDBODY” or the “Company”) was incorporated in California in 2004 and reincorporated in Delaware in March 2015. MINDBODY is headquartered in San Luis Obispo, California and has operations in the United States, the United Kingdom, and Australia.
MINDBODY and its wholly owned subsidiaries (collectively, the “Company”, “we”, “us” or “our”) is a provider of cloud-based business management software for the wellness services industry and a growing consumer brand. Its integrated software and payments platform helps business owners in the wellness services industry run, market and build their businesses. MINDBODY enables the consumers to evaluate, engage, and transact with local businesses in its marketplace.
In May 2017, MINDBODY completed a follow-on public offering in which it issued and sold 5,060,000 shares of Class A common stock at a public offering price of $27.95 per share. MINDBODY received net proceeds of $134,709,000 after deducting underwriters’ discounts and commissions of $6,718,000, but before deducting offering expenses of approximately $443,000.
Basis of Presentation and Consolidation
The accompanying unaudited condensed consolidated financial statements are presented in accordance with United States generally accepted accounting principles (“GAAP”), which include the accounts of MINDBODY and its wholly owned foreign subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.
The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP, and follow the requirements of the Securities and Exchange Commission (“SEC”), for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted. These financial statements have been prepared on the same basis as the Company’s annual financial statements and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments that are necessary for a fair statement of the Company’s financial information. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2017. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted under the rules and regulations of the SEC.
These condensed consolidated financial statements and related financial information should be read in conjunction with the audited consolidated financial statements and related notes thereto for the year ended December 31, 2016 included in the Annual Report on Form 10-K (the “Annual Report”), which was filed with the SEC on March 1, 2017.
Use of Estimates
The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the capitalization and estimated useful life of the Company’s capitalized internal-use software, useful lives of property and equipment, the determination of fair value of stock awards issued and forfeiture rates, a valuation allowance for deferred tax assets, contingencies, and the purchase price allocation of acquired businesses. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances. Changes in facts or circumstances may cause the Company to change its assumptions and estimates in future periods, and it is possible that actual results could differ from current or future estimates.
Concentration of Credit Risk

As of September 30, 2017, one customer represented 17% of the accounts receivable balance. As of December 31, 2016, one customer represented 15% of the accounts receivable balance. No single customer represented over 10% of revenue for any of the periods presented in the consolidated statements of operations.

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Summary of Significant Accounting Policies

There have been no material changes in the Company's significant accounting policies, other than the adoption of Accounting Standards Update (ASU) 2016-09 described below under the heading Recently Adopted Accounting Pronouncements and in Note 9, as compared to the significant accounting policies described in the Company's Annual Report.

Recently Adopted Accounting Pronouncements

On March 30, 2016, the Financial Accounting Standards Board ("FASB") issued authoritative guidance related to employee Share-Based Payment Transactions. The new guidance requires entities to recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement and provides guidance on the related cash flow presentation. The new guidance also allows entities to make an accounting policy election to either continue to estimate the total number of awards for which the requisite service period will not be rendered (as currently required) or to account for forfeitures when they occur. The new guidance also stipulates that the net settlement of an award for statutory tax withholding purposes would not result, by itself, in liability classification of the award provided that the amount withheld for taxes does not exceed the maximum statutory tax rate in the employees' relevant tax jurisdictions. Effective January 1, 2017, we adopted this standard. In accordance with this standard, we elected to continue our historical approach of estimating forfeitures during the award vesting period. The adoption of this standard did not have a material effect on our consolidated financial statements for the three and nine months ended September 30, 2017.

Recently Issued Accounting Pronouncements

In May 2017, the FASB issued authoritative guidance related to employee Share-Based PaymentsTransactions. The new guidance clarifies which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments in this guidance are effective for fiscal years beginning after December 15, 2017, including interim periods within those years. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The Company intends to adopt the guidance on the effective date and does not expect the adoption of the new guidance to have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued authoritative guidance related to Clarifying the Definition of a Business. The new guidance clarifies whether transactions should be accounted for as acquisitions of assets or businesses. To be considered a business, the assets in the transaction need to include an input and a substantive process that together significantly contribute to the ability to create outputs. Prior to the adoption of the new guidance, an acquisition or disposition would be considered a business if there were inputs, as well as processes that when applied to those inputs had the ability to create outputs. The standard is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company intends to adopt the guidance on the effective date and the adoption of the new guidance may have a material impact on the Company's consolidated financial statements if it enters into future business combinations.

In January 2017, the FASB issued authoritative guidance related to Simplifying the Test for Goodwill Impairment. The new guidance simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test. The standard is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company intends to adopt the guidance on the effective date and does not expect the adoption of the new guidance to have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued authoritative guidance intended to improve financial reporting about leasing transactions. The new guidance requires entities to recognize assets and liabilities for leases with lease terms of more than 12 months. The new guidance also requires qualitative and quantitative disclosures regarding the amount, timing, and uncertainty of cash flows arising from leases. The new guidance is effective for the Company beginning January 1, 2019. The Company is evaluating the impact of the new standard on its consolidated financial statements

and anticipates recording certain operating leases on the balance sheet upon adoption.

In August 2016, the FASB issued authoritative guidance related to the Classification of Certain Cash Receipts and Cash Payments. The new guidance standardizes cash flow statement classification of certain transactions, including cash payments for debt prepayment or extinguishment, proceeds from insurance claim settlements, and distributions received from equity method investments. The new guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The amendments in this update should be applied using a retrospective transition method to each period presented. If impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. We will adopt the new standard as of January 1, 2018.

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In May 2014, the FASB issued authoritative guidance that provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services (“ASC 606”). ASC 606 also requires that reporting companies disclose the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In April 2016, the FASB issued an update clarifying ASC 606, related to identifying performance obligations and licensing implementation guidance contained in ASC 606. In May 2016, the FASB issued an update that provides narrow scope improvements and practical expedients related to ASC 606. The improvements address completed contracts and contract modifications at transition, non-cash consideration, the presentation of sales taxes and other taxes collected from customers, and assessment of collectability when determining whether a transaction represents a valid contract. The Company is still in the process of evaluating the impact of adopting this new guidance on its revenue contracts including reviewing current accounting policies, evaluating new disclosure requirements, identifying appropriate changes to business processes, information technology systems, and internal controls to support revenue recognition, and disclosure under the new guidance. The Company has concluded that the new guidance will impact the Company’s timing of expensing incremental costs of obtaining a contract, such as sales commissions. The Company has identified certain sale commission structures that will qualify for capitalization upon adoption of the new standard and is currently in the process of evaluating these sale commission structures, the magnitude of the impact, and the period over which to amortize these costs. The Company also has determined that another area of impact is revenue recognition on contracts which include contingent amounts of variable consideration that it was precluded from recognizing because of the requirement for amounts to be “fixed or determinable” under SAB Topic 13. It is expected that ASC 606 will require the Company to estimate these amounts. As a result, the Company will recognize revenue earlier under ASC 606 than it would have done under current guidance. The Company is still in the process of completing its assessment of the impact of adopting this new guidance on revenue recognition, but it is not expected to have a material impact. The Company will adopt this new guidance in the first quarter of 2018 by recognizing any cumulative effect on revenue in the opening balance of retained earnings.

2. FAIR VALUE MEASUREMENTS

The Company measures and reports its cash equivalents at fair value on a recurring basis. The Company’s cash equivalents are invested in money market funds.

The following table sets forth the fair value of the Company’s financial assets, by level within the fair value hierarchy (in thousands):

	September 30, 2017			
	Level 1	Level 2	Level 3	Total
Financial Assets:				
Money market funds(1)	$220,226	$ —	$—	$220,226
Equity:				
Acquisition-related contingent consideration(2)	$—	$ —	$5,142	$5,142

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Financial Assets:				
Money market funds(1)	$81,878	$ —	$ —	$81,878

(1) The Company held certain assets that are required to be measured at fair value on a recurring basis, included in cash equivalents, which are held in money market funds. All such assets as of September 30,

2017 and December 31, 2016 were recorded based on Level 1 inputs.

(2) The contingent consideration related to the acquisition of Lymber (Note 4) is recorded as equity and is not subject to remeasurement. Fair value was based on significant inputs not observable in the market, which represents a Level 3 measurement within the fair value hierarchy. The Company determined the fair value of the contingent consideration by discounting payments that are calculated based on Lymber's projected future gross profit scenarios using the Monte Carlo simulation. The significant inputs used in the fair value measurement of contingent consideration are the timing and amount of gross profit in the respective periods (Note 4) and the discount rate.

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There were no transfers of financial instruments between the three levels of the fair value hierarchy during the nine months ended September 30, 2017. As of September 30, 2017 and December 31, 2016, the Company did not have any assets or liabilities that were required to be measured at fair value on a nonrecurring basis.

3. BALANCE SHEET COMPONENTS

Property and Equipment, net

Property and equipment consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Computer equipment	$ 20,333	$ 17,262
Leasehold improvements	12,055	11,123
Capitalized software development costs	2,751	1,877
Office equipment	2,883	2,668
Software licenses	4,974	3,258
Building, leased	16,438	16,438
Property and equipment, gross	59,434	52,626
Less: accumulated depreciation and amortization	(24,950)	(19,522)
Property and equipment, net	$ 34,484	$ 33,104

Depreciation and amortization expense, excluding amortization of capitalized software and intangible assets, for the three months ended September 30, 2017 and 2016 was $1,921,000 and, $1,839,000 respectively. Depreciation and amortization expense, excluding amortization of capitalized software and intangible assets, for the nine months ended September 30, 2017 and 2016 was $5,725,000 and $5,190,000, respectively.

The Company capitalized software development costs of $774,000 and zero for the three months ended September 30, 2017 and 2016, respectively. The Company capitalized software development costs of $1,011,000 and $114,000 for the nine months ended September 30, 2017 and 2016, respectively. The Company amortized software development costs of $6,000 and $65,000 during the three months ended September 30, 2017 and 2016, respectively. The Company amortized software development costs of $20,000 and $220,000 during the nine months ended September 30, 2017 and 2016, respectively. The net book value of capitalized software development costs was $1,011,000 and $20,000 as of September 30, 2017 and December 31, 2016, respectively.

The Company occupies office space constructed under a build-to-suit lease arrangement for which the Company is considered the “deemed owner” for accounting purposes. As such, building costs were recorded to “Building, leased” within “Property and equipment, net” and a related financing obligation was recorded in April 2015, when the Company began to occupy the building.

Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Accrued payroll	$ 6,504	$ 6,072
Accrued vacation	2,474	2,069
Employee stock purchase plan contributions	526	1,171
Other liabilities	1,353	1,158
Total accrued expenses and other liabilities	$ 10,857	$ 10,470

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4. BUSINESS COMBINATION

Lymber

On March 27, 2017, the Company completed the acquisition of substantially all of the assets of Lymber Wellness, Inc. (“Lymber”), a privately-held application programming interface (“API”) partner that specializes in yield management solutions for class and appointment-based businesses. Lymber’s technology enables business owners to set dynamic pricing parameters for class and appointment sessions. The technology identifies open class and appointment inventory, and automatically adjusts session prices in real-time to match supply and demand.

The total purchase consideration for these assets was $7,342,000, which included cash consideration of $2,200,000, of which $750,000 was held back to satisfy potential indemnification claims, of which $250,000 has been paid as of September 30, 2017, and $500,000 is included in other current liabilities; and contingent consideration with a fair value of approximately $5,142,000, of which $1,304,000 and $3,838,000 are expected to be earned in 2018 and 2019 respectively, payable in shares of the Company’s Class A common stock. This consideration is contingent upon Lymber’s product achieving certain levels of gross profit, measured annually, in 2018 and 2019, respectively, and the fair value of the equity classified contingent consideration was measured using a Monte Carlo simulation with various unobservable market data inputs, which are Level 3 measurements.

The acquisition of Lymber was accounted for in accordance with the acquisition method of accounting for business combinations with MINDBODY as the accounting acquirer. Acquisition-related costs incurred and expensed by the Company were immaterial and were included within general and administrative expenses on the consolidated statements of operations. Under the acquisition method of accounting, the total purchase consideration is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. Goodwill of $2,544,000 was allocated to the Company’s one operating segment and represents 35% of the total purchase consideration. Goodwill is primarily attributable to expanded market opportunities from selling and integrating Lymber’s yield management solution with the Company’s other offerings and the associated assembled workforce acquired. Goodwill is amortized over 15 years for tax purposes.

The acquisition provided the Company with acquired intangible assets representing internally developed software/technology. The fair value of the acquired intangible asset was determined based on the income approach and discounted cash flow/excess earnings method and is subject to amortization on a straight-line basis over its remaining useful life of five years.

The allocation of the purchase price consideration is as follows (in thousands):

	Amount
Intangible asset – developed software/technology	$ 4,798
Goodwill	2,544
Fair value of total purchase consideration	$ 7,342

The results of Lymber are included in the Company’s consolidated statements of operations since the acquisition date, including revenues and net loss, and were not material. Pro forma results of operations have not been presented because the acquisition was not material to the Company’s results of operations.

Contemporaneous to signing the purchase agreement, the stockholders of Lymber amended the existing company charter to effectively increase the distribution of ownership interest to existing stockholders who continued as employees with MINDBODY. The change in the ownership interest is viewed to have benefited MINDBODY, and as such, a portion of the contingent consideration discussed above is attributed to post-acquisition expense. The approximate fair value of this consideration is $2,547,000, of which $646,000 and $1,901,000 relate to the 2018 and 2019 earnouts, respectively. This post-acquisition expense is recorded as non-cash operating expense over the requisite service periods.

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HealCode

On September 1, 2016, the Company completed the acquisition of substantially all of the assets of HealCode LLC ("HealCode"), a privately held technology partner that creates web-based and mobile application widgets for the Company's subscribers. HealCode's "website widget" solutions enable the Company's subscribers to embed the MINDBODY class and appointment schedules within their web and social sites. The fair value of the acquired intangible asset was determined based on the income approach and discounted cash flow/excess earnings method and is subject to amortization on a straight-line basis over its remaining useful life.

The total purchase consideration of $5,388,000 consisted of the payment of $4,888,000 in cash, of which $750,000 is recorded in other current liabilities for purchase consideration which has been held back by the Company for a period of eighteen (18) months, payable March 1, 2018, to satisfy potential indemnification claims, and the issuance of 28,959 shares of the Company's Class A common stock at a total acquisition date fair value of $500,000.

The acquisition of HealCode was accounted for in accordance with the acquisition method of accounting for business combinations with MINDBODY as the accounting acquirer. The Company incurred and expensed de minimis acquisition-related costs, which are included within general and administrative expenses on the consolidated statements of operations. The acquisition provided the Company with acquired intangible assets representing internally developed software/technology. Under the acquisition method of accounting, the total purchase consideration is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. Goodwill of $3,643,000 was allocated to the Company's one operating segment and represents 68% of the total purchase consideration. Goodwill is primarily attributable to expanded market opportunities from selling and integrating HealCode's "website widget" solution with the Company's other offerings and the associated assembled workforce acquired. Goodwill is amortized over 15 years for tax purposes.

The allocation of the purchase price consideration is as follows (in thousands):

	Amount
Liabilities assumed	$(105)
Tangible assets acquired	32
Intangible asset – developed software/technology	1,818
Goodwill	3,643
Fair value of total purchase consideration	$5,388

The results of HealCode are included in the Company's consolidated statements of operations since the acquisition date, including revenues and net loss, and were not material. Pro forma results of operations have not been presented because the acquisition was not material to the Company's results of operations.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill amounts are not amortized, but rather tested for impairment at least annually in the fourth quarter of the financial year. The Company has recorded goodwill and other intangible assets as a result of its business acquisitions of Lymber on March 27, 2017 and HealCode on September 1, 2016. The goodwill balance was $11,583,000 as of September 30, 2017 and $9,039,000 as of December 31, 2016. There have been no impairment charges recorded against goodwill.

The Company's intangible assets consisted of the following (in thousands except years):

	September 30, 2017			
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Network list	2	$ 420	$ (420)	$ —
Technology	3 to 5	7,529	(1,694)	5,835
Total intangible assets		$ 7,949	$ (2,114)	$ 5,835

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	December 31, 2016			
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Network list	2	$ 420	$ (420)	$ —
Technology	3 to 5	2,731	(704)	2,027
Total intangible assets		$ 3,151	$ (1,124)	$ 2,027

Amortization expense for intangible assets with finite lives was $410,000 and $109,000 for the three months ended September 30, 2017 and 2016. Amortization expense for intangible assets with finite lives was $991,000 and $261,000 for the nine months ended September 30, 2017 and 2016.

The expected future annual amortization expense of intangible assets as of September 30, 2017 is presented below (in thousands):

Year Ending December 31,	
2017 (Remaining three months)	$412
2018	1,348
2019	1,322
2020	1,326
2021	1,201
Thereafter	226
Total amortization expense	$5,835

6. DEBT

Credit Facility

On January 12, 2015, the Company entered into a loan agreement with Silicon Valley Bank for a secured revolving credit facility that allows the Company to borrow up to $20,000,000 for working capital and general business requirements. The Company has not drawn down any amounts under the loan . The loan agreement is set to expire in January 2018.

7. COMMITMENTS AND CONTINGENCIES

Operating Lease

The Company leases office facilities under various non-cancelable operating lease agreements with original lease periods expiring between 2017 and 2026. Rent expense was $1,705,000 and $1,219,000 for the three months ended September 30, 2017 and 2016, respectively. Rent expense was $4,575,000 and $3,515,000 for the nine months ended September 30, 2017 and 2016, respectively.

Financing Obligation

The Company occupies office space in San Luis Obispo, California, constructed under a 15 year build-to-suit lease arrangement for which the Company is considered the “deemed owner” for accounting purposes. The lease has an initial term of 15 years and the Company has an option to extend the term of the lease for three consecutive terms of five years each. The portion of the lease obligation allocated to the building for accounting purposes is being treated as a financing obligation. The portion of the lease obligation allocated to the land for accounting purposes is being treated as an operating lease. The financing obligation is being settled through the monthly lease payments. In the table below, the remaining future minimum lease payments on the building, leased, include interest of $9,400,000 to be recognized over the remainder of the initial term of the lease agreement. The total financing obligation as of September 30, 2017 is $15,562,000, of which $496,000 is recorded as a current obligation.

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Future Minimum Lease Payments

Future minimum lease payments under non-cancelable lease agreements as of September 30, 2017 were as follows (in thousands):