SHUTTERFLY INC
2019 PROXY STATEMENT
AND 2018 ANNUAL REPORT

The following infographic shall not be deemed "filed" for purposes of section 18 of the Securities and Exchange Act of 1934, as amended, or otherwise subject to the liabilities under that section and shall not be deemed to be incorporated by reference into any filing of Shutterfly under the Securities Act of 1933, as amended or the Securities and the Exchange Act of 1934, as amended. See "Non-GAAP Financial Measures" of the Proxy Statement below for a reconciliation of Adjusted EBITDA, free cash flow and free cash flow conversion, all of which are non-GAAP measures, to the most comparable GAAP measures.

This proxy statement reflects the version filed with the Securities and Exchange Commission on April 8, 2019.

WHO WE ARE

LEADING CONSUMER FRANCHISE PAIRED WITH A HIGH POTENTIAL ENTERPRISE OPPORTUNITY

CONSUMER

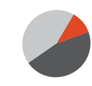
Shutterfly — 46% REVENUE*

The leading digital retailer and manufacturer of high-quality personalized products and services. Shutterfly Consumer brings photos to life in photo books, personalized gifts, home décor, cards, stationery, calendars and prints.

Lifetouch — 43% REVENUE*

Built on the tradition of "Picture Day," Lifetouch captures smiling faces, preschool through high school graduation. Additional product lines include portrait studios, yearbooks, sports, events and churches.

ENTERPRISE



Shutterfly BUSINESS SOLUTIONS — 11% REVENUE*

Variable print-on-demand solutions for large enterprises. Shutterfly Business Solutions delivers digital printing services that enable efficient and effective customer engagement through personalized communications.

*Percentages based on 12 months of Lifetouch revenue. Lifetouch was acquired on April 2, 2018.

2018 BY THE NUMBERS

$2.0B REVENUES

50B+ HOSTED PHOTOS*

~$41 AVERAGE ORDER VALUE*

24M ANNUAL ORDERS*

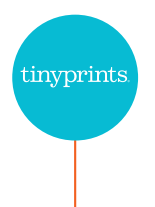
~80% REVENUE FROM RETURNING CUSTOMERS*

10M CONSUMERS*

46% FREE CASH FLOW CONVERSION†

*Shutterfly Consumer figures

SHUTTERFLY PRODUCT CATEGORY EVOLUTION



- 1999: PRINTS
- '00: CARDS
- '01: CALENDARS
- '02: PHOTO GIFTS
- '03: PHOTO BOOKS
- '08: CARDS EXPANSION
- '11: TINY PRINTS ACQUISITION
- '12: HOME DECOR / PHOTO GIFTS EXPANSION
- '15: STATEMENT GIFTS
- '16: TINY PRINTS BOUTIQUE / SHUTTERFLY WEDDING SHOP
- '18: LIFETOUCH ACQUISITION
- 2019: KIDS & PETS

1999 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16 '17 '18 2019

2019 TO 2021

2019 FOCUS

- Continued range expansion
- Drive mobile monetization
- Increase personalization and targeting
- Drive participation of Lifetouch through awareness programs
- Leverage Shutterfly Photos at Lifetouch
- Focus Enterprise on existing customers and grow pipeline

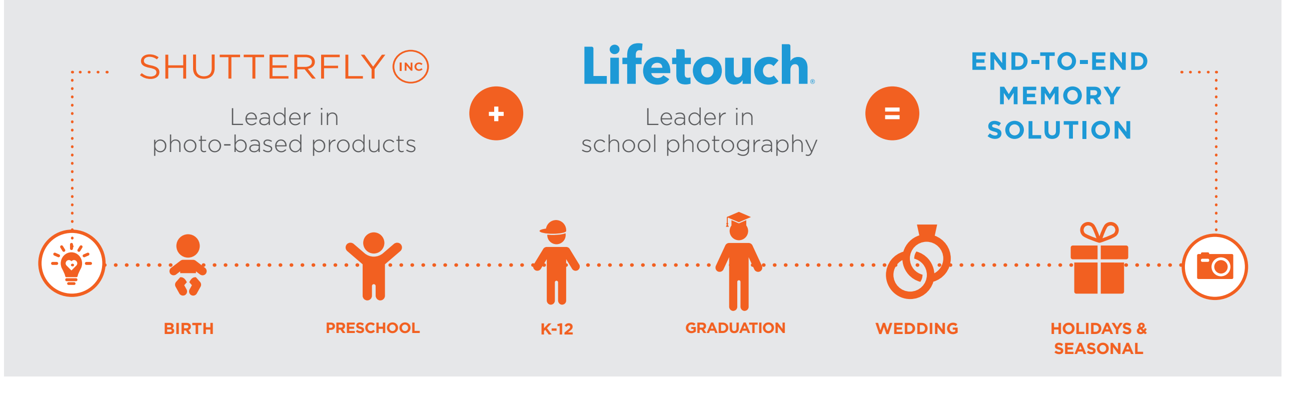
ACTIVE CUSTOMERS

15M+ Lifetouch Consumers*

Lifetouch low-cost customer acquisition vehicle

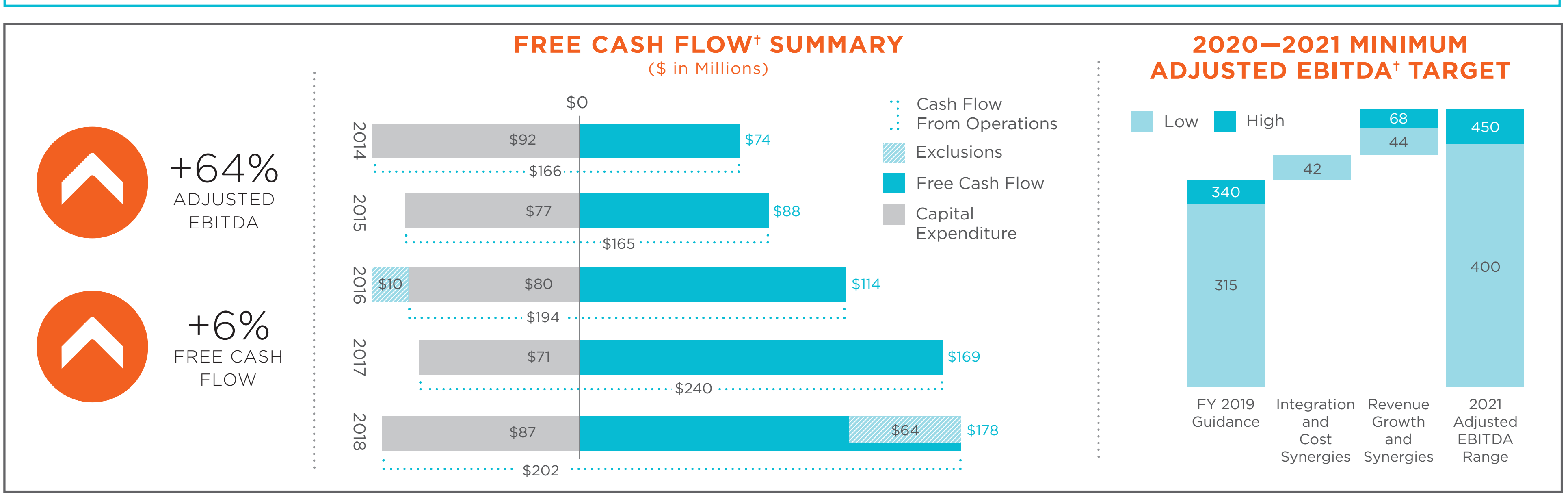
10M Shutterfly Consumers

*3-year active consumers



+64% ADJUSTED EBITDA

+6% FREE CASH FLOW



† Non-GAAP measures

LETTER FROM THE CEO AND CHAIRMAN OF THE BOARD

SHUTTERFLY INC

April 5, 2019

DEAR STOCKHOLDERS,

2018 was a transformational year for Shutterfly. We almost doubled the size of the company with the Lifetouch, Inc. ("Lifetouch") acquisition; we completed the first full year on a consolidated website platform in the Shutterfly Consumer division, greatly simplifying the business while improving profitability; and we continued to drive the growth and expansion of our enterprise business, Shutterfly Business Solutions. As a result, Shutterfly today encompasses an attractive portfolio of scaled, industry-leading businesses each with loyal customers and significant cash flow.

We believe the future is bright for Shutterfly. We believe the Company is well-positioned to significantly increase stockholder value over the next few years by driving growth in all three of our divisions, by delivering substantial cost and revenue synergies from the Lifetouch integration, and by returning capital to stockholders.

We made significant progress against our strategic initiatives in 2018. In Shutterfly Consumer, mobile continues its extraordinary growth, with app revenues growing 59% year-over-year to 20% of Shutterfly.com revenue in 2018. We also significantly reaccelerated the growth of our Personalized Gifts and Home Décor categories, with 15% growth in the category as compared to the fourth quarter in 2017. We launched 47 new products in 2018, double the number launched in 2017, and introduced the new Kids and Pets categories. Our app also helped drive more photos to Shutterfly Photos which now hosts over 50 billion photos, driving customer engagement and loyalty. And, we laid the foundation for increasingly personalized and targeted marketing and promotions with new platforms, while welcoming new leadership to the company to spearhead these efforts. These areas of strength were offset by mixed results in the Shutterfly Consumer business in 2018, in particular the disappointing performance in our prints and holiday cards businesses. Our 2019 plans build on our strengths and directly address the areas of underperformance, as discussed below.

We are especially excited about the Lifetouch opportunity. By bringing Lifetouch together with Shutterfly, we are building a unique value proposition for our customers. We are combining Shutterfly's strengths as the leader in personalized photo-based products and photo storage, together with Lifetouch's strengths as the leader in school and family photography, to create the first and only end-to-end memory solution for families. Together, Shutterfly and Lifetouch will help customers capture, preserve, and share the most important memories in their lives.

We officially welcomed Lifetouch to the family on April 2, 2018 and are pleased with the performance of the business. In this last Fall School Picture Day season, Lifetouch increased the number of accounts, or schools, that they serve, with improved retention as well as an increase in new accounts.

And we're off to a running start on integration. In the fourth quarter of 2018, we tested a number of marketing initiatives that inform our plans for technology and marketing initiatives in 2019. Importantly, we also brought our manufacturing teams together to develop a robust plan for cost synergies centered around establishing a common manufacturing platform, and completed hundreds of integrations in our combined businesses.

Meanwhile, we also continued to see strong growth in our SBS business along with margin improvement. SBS grew 19% year-over-year in 2018, after successfully onboarding a major new program signed in the second half of 2017.

Our vision is to make the world a better place by helping people share life's joy.

While we had many successes in 2018, we also gained a clearer view of challenges we need to tackle aggressively. In Shutterfly Consumer, we will continue to build on our success in mobile, broaden our range of products and category expansion, and reaccelerate the growth of our popular personalized gifts and home décor lines, while improving our offer and execution in more competitive categories like prints and our holiday cards. In all these areas, we are also focused on making the right marketing and promotional investments to support profitable growth. At Lifetouch, we will continue to drive account growth in schools and preschools, while improving the participation rate through awareness supported by direct-to-consumer communications. And in SBS, we will continue to focus on servicing our existing large customers and landing large new customers.

Going forward, we believe our largest opportunity to accelerate growth at Shutterfly Consumer is to extend our value proposition to Lifetouch's estimated 15 million three-year active customers. Our tests since the acquisition seem to confirm that Lifetouch customers want their photos on Shutterfly and see it as a natural extension of their Lifetouch buying experience. We will therefore position Shutterfly Photos as the default delivery method for digital images, while at the same time expanding the business units, programs and Lifetouch packages that are eligible for digital delivery. The integrated experience will be seamless with a single set of account credentials across Lifetouch and Shutterfly for Lifetouch's most important businesses.

Beyond the revenue opportunity, we are also investing in initiatives that will, over time, expand the efficiencies we originally anticipated from the acquisition. With Project Aspen we will establish a single, next-generation manufacturing platform. In phase one of this plan we plan to close four existing Lifetouch manufacturing facilities and open a modern 237,000 square foot facility in Texas in the first half of 2020. Over the next five years, we expect Project Aspen to yield $130 million in cash cost savings, while also enabling us to offer broader product selection, higher quality, and faster delivery.

While we have significant work ahead, we also have strong assets that form the foundation of a powerful business platform. It's useful to consider our plans by reflecting on the journey that Shutterfly has embarked on over the last three years. In that time, we have:

- Strengthened and diversified our business profile around a consolidated Shutterfly Consumer business, Lifetouch and SBS.
- Articulated our areas of strategic focus and executed against those plans with strong results including mobile, category and range expansion, and SBS growth.
- Almost doubled the size of the company while delivering financial improvements, including the quality of earnings.

We believe these achievements set the stage for a significant value creation opportunity at Shutterfly over the next few years. As we do so, we expect later this year to mark a new chapter in leadership of Shutterfly as Chris returns to London with his family at the end of the summer. As a board and management team, we are working closely together to identify the next leader who will take Shutterfly forward and achieve its tremendous promise.

Our priorities looking forward are clear:

- Drive growth in all three of our divisions.
- Deliver substantial cost and revenue synergies from our Lifetouch acquisition.
- Return excess capital to stockholders.

In closing, we want to thank you for your continued support.

Sincerely,

CHRISTOPHER NORTH
President and Chief Executive Officer

WILLIAM J. LANSING
Chairman of the Board

NON-GAAP FINANCIAL MEASURES

This Proxy Statement contains Non-GAAP financial measures. The following tables reconcile the Non-GAAP financial measures that the Company uses to the most directly comparable financial measures prepared in accordance with Generally Accepted Accounting Principles (GAAP). These Non-GAAP financial measures include Adjusted EBITDA, free cash flow and free cash flow conversion. The method the Company uses to produce Non-GAAP financial measures is not computed according to GAAP and may differ from methods used by other companies. We define "Adjusted EBITDA" as earnings before interest, taxes, depreciation, amortization, stock-based compensation, capital lease termination, restructuring, acquisition costs and purchase accounting adjustments. We define "free cash flow" as net cash provided by operating activities less capital expenditures. We define "free cash flow conversion" as the ratio of free cash flow to Adjusted EBITDA.

To supplement the Company's consolidated financial statements presented on a GAAP basis, we believe that these Non-GAAP measures provide useful information about the Company's core operating results and thus are appropriate to enhance the overall understanding of the Company's past financial performance and its prospects for the future. These adjustments to the Company's GAAP results are made with the intent of providing both management and investors a more complete understanding of the Company's underlying operational results and trends and performance. Management uses these Non-GAAP measures to evaluate the Company's financial results, develop budgets, manage expenditures, and determine employee compensation. The presentation of additional information is not meant to be considered in isolation or as a substitute for or superior to operating income (loss), net income (loss), or cash flows provided by (used in) operating activities determined in accordance with GAAP. For more information, please see Shutterfly's SEC Filings, including the most recent Form 10-K and Form 10-Q, which are available on the Securities and Exchange Commission's Web site at www.sec.gov.

We have provided a reconciliation of each Non-GAAP financial measure to the most directly comparable GAAP financial measure where possible, except we have not reconciled the 2020-2021 Minimum Non-GAAP Adjusted EBITDA target preceding this Proxy Statement to comparable GAAP operating income at this stage because it is unreasonably difficult to provide guidance for stock-based compensation expense; capitalization and amortization of internal-use software; costs related to executive transition, the strategic review and the facility closures in 2019; any non-recurring charges related to the $200 million debt repayment made in January 2019; and proceeds from the sale of existing facilities, which are reconciling items between GAAP operating income and Non-GAAP Adjusted EBITDA. The factors that may impact our stock-based compensation expense; capitalization and amortization of internal-use software; and costs related to executive transition, the strategic review, the facility closures in 2019 and the proceeds from the sale of existing facilities are out of our control and/or cannot be reasonably predicted, and therefore we are unable to provide such guidance without unreasonable effort. Factors include our market capitalization and related volatility of our stock price; our inability to project the cost or scope of internally produced software; our inability to estimate the charges related to the facility closures in 2019 and the proceeds from the sale of existing facilities; our ability to attract new management personnel; and the lack of assurance that the review of strategic alternatives will result in a transaction or other outcome.

RECONCILIATION OF NET INCOME (LOSS) TO NON-GAAP ADJUSTED EBITDA (In Thousands)

	YEAR ENDED DECEMBER 31,				
	2018	2017	2016	2015	2014
Net income (loss)	$ 50,396	$ 30,085	$ 15,906	$ (843)	$ (7,860)
Add back:					
Interest expense	61,239	27,836	23,023	20,998	16,732
Interest and other income, net	(5,444)	(1,481)	(501)	(744)	(508)
Benefit from (provision for) income taxes	9,262	5,160	10,682	(1,146)	(2,119)
Depreciation and amortization	151,127	103,862	113,651	113,277	98,752
Stock-based compensation expense	47,721	43,573	45,692	60,458	61,762
Capital lease termination	—	8,098	—	—	—
Restructuring	4,618	16,966	—	—	—
Acquisition-related charges	15,549	—	—	—	—
Purchase accounting adjustments	50,538	—	—	—	—
Non-GAAP Adjusted EBITDA	$385,006	$234,099	$208,453	$192,000	$166,759

RECONCILIATION OF CASH FLOW FROM OPERATING ACTIVITIES TO NON-GAAP FREE CASH FLOW (In Thousands)

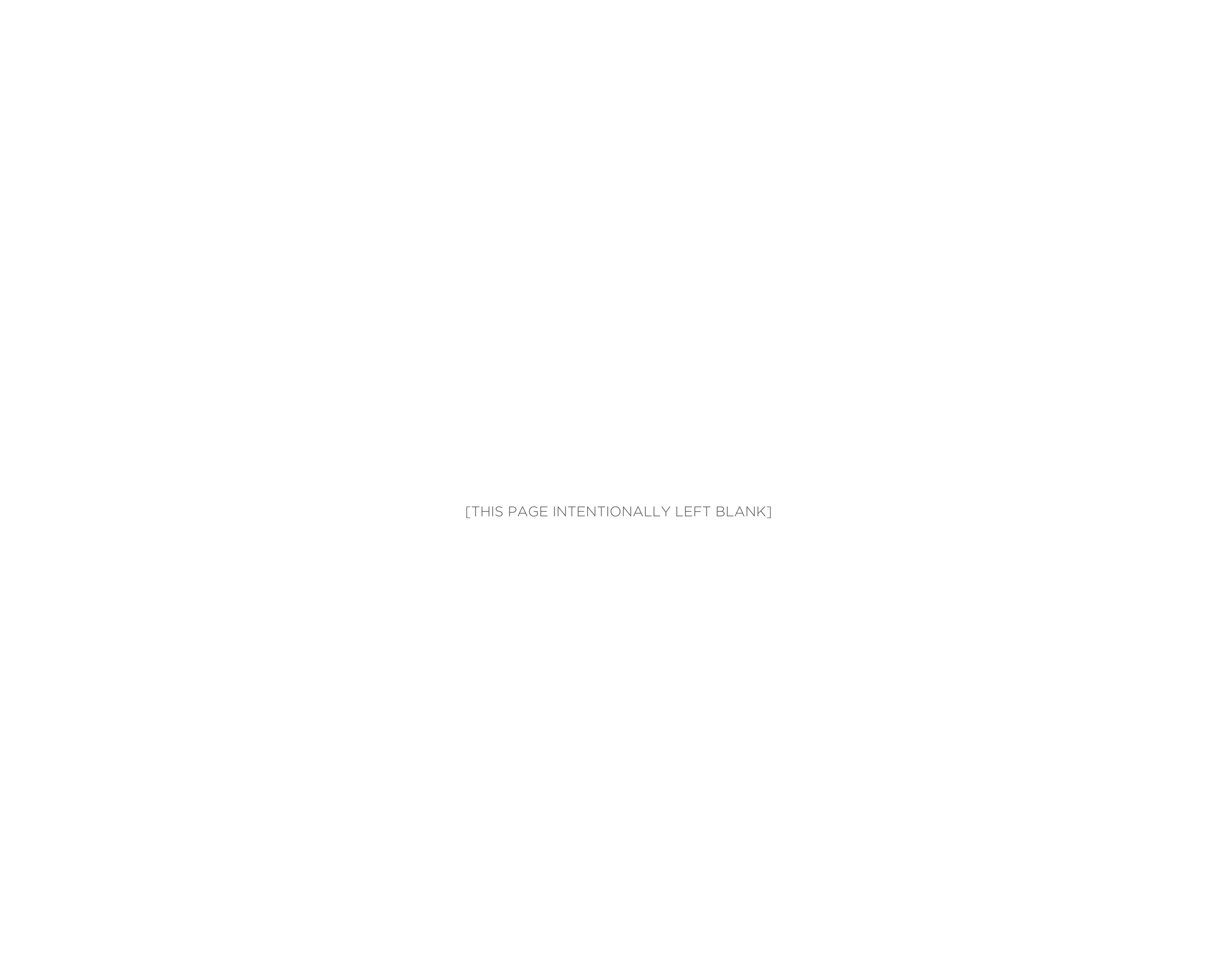
	YEAR ENDED DECEMBER 31,				
	2018	2017	2016	2015	2014
Net cash provided by operating activities (1)	$265,436	$239,524	$193,423	$165,037	$166,488
Less: Capital expenditures (2)	87,274	70,751	79,860	76,669	92,201
Free Cash Flow	$178,162	$168,773	$113,563	$ 88,368	$ 74,287

(1) Net cash provided by operating activities for 2018 excludes $64 million related to certain cash outflows attributable to the repayment of the accreted interest on the convertible senior notes that were settled in the second quarter of 2018.

(2) Capital expenditures for 2016 excludes purchase of printers of $9.8 million that we acquired and immediately sold during the second quarter of 2016.

NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Proxy Statement, including in the introduction and summary pages, other than purely historical information, are “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which involve risks and uncertainties. These forward-looking statements include estimates, projections, statements relating to our future being bright, articulating a unique value proposition to our customers, our largest opportunity to accelerate growth at Shutterfly Consumer, the results from our product integrations, the positioning of Shutterfly photos as the delivery method for digital images, our foundation of strong assets, our business strategy with respect to each of our three business segments and our positioning to create stockholder value. Forward-looking statements may appear throughout this report, including without limitation, the “Compensation Discussion and Analysis.” You can identify these statements by the use of terminology such as “believe”, “expect”, “will”, “should,” “could”, “estimate”, “anticipate” or similar forward-looking terms. Factors that might contribute to such differences include, among others, decreased consumer discretionary spending as a result of general economic conditions; our ability to expand our customer base and increase sales to existing customers; our ability to meet production requirements; our ability to attract and retain management and other personnel; our ability to retain and hire necessary employees, including seasonal personnel, and appropriately staff our operations; the impact of seasonality on our business; our ability to develop innovative, new products and services on a timely and cost-effective basis; failure to realize the anticipated benefits of our 2017 restructuring activities or of the Lifetouch acquisition; recent and ongoing restructuring activities (including but not limited to those relating to manufacturing consolidation, Lifetouch field operations and our single platform migration); consumer acceptance of our products and services; our ability to develop additional adjacent lines of business; unforeseen changes in expense levels; a deterioration in the relationship with any of our business partners; refining our promotional strategies; competition and the pricing strategies of our competitors, which could lead to pricing pressure; a failure to implement new technology systems; a decline in participation rate in the Lifetouch business; the retention of Lifetouch employees and our ability to successfully integrate the Lifetouch businesses; risks inherent in the achievement of anticipated synergies and the timing thereof; general economic conditions and changes in laws and regulations and the other risks set forth below the heading “Risk Factors” in our Form 10-K for the year ended December 31, 2018. You should not rely on these forward-looking statements as they involve risks and uncertainties that may cause actual results to vary materially from the forward-looking statements. For more information regarding the risks and uncertainties that could cause actual results to differ materially from those expressed or implied in these forward-looking statements, as well as risks relating to our business in general, we refer you to the “Risk Factors” section of our SEC filings, including our most recent Form 10-K and 10-Q, which are available in the “Investor Relations” section of our website at *ir.shutterfly.com/financial-information/sec-filings.* These forward-looking statements are based on current expectations and the Company assumes no obligation to update this information.



[THIS PAGE INTENTIONALLY LEFT BLANK]

PROXY SUMMARY

YOUR VOTE MATTERS

This summary highlights information described in more detail elsewhere in this Proxy Statement. We recommend that you read the entire Proxy Statement carefully and consider all information before voting. Page references are supplied to help you find further information in this proxy statement.

VOTING MATTERS, VOTE RECOMMENDATIONS AND RATIONALE

PROPOSAL	BOARD RECOMMENDS
Proposal 1: Election of Directors (page 7) The Corporate Governance Committee and the Board believe that the Director nominees and the entire Board provide Shutterfly with a diverse range of perspectives and business acumen and allow our Directors to effectively engage each other and management to effectively address our evolving needs and represent the best interests of our stockholders.	**FOR Each Nominee**
Proposal 2: Non-Binding Advisory Vote to Approve the Compensation of our Named Executive Officers ("Say-on-Pay" vote) (page 24) As described in detail under the heading "Compensation Discussion and Analysis," the objective of our executive compensation program is to attract, motivate and retain the exceptional leaders we need to drive stockholder value, fulfill our vision and mission, uphold our company values and achieve our corporate goals. We accomplish these goals in a manner consistent with our strategy, competitive practice, sound corporate governance guidelines, and stockholder interests and concerns. We believe the compensation program for our Named Executive Officers for 2018 was strongly aligned with the long-term interests of our stockholders and the changes made to enhance our programs over the last three years have been effective in driving stockholder value creation.	**FOR**
Proposal 3: Amendment of 2015 Equity Incentive Plan (pages 57 to 64) The proposed amendment to our 2015 Equity Incentive Plan would increase the number of shares available for issuance thereunder by 1,000,000 shares and make certain modifications to reflect recent changes in applicable tax laws resulting from the Tax Cuts and Jobs Act of 2017. Our Board believes the Company's success is due to its highly talented employee base and that future success depends on our ability to continue attracting and retaining high-caliber employees. Our operations are primarily located in Silicon Valley, where we compete with many technology companies, including high profile start-ups, for a limited pool of talented people. Our ability to grant equity awards is a necessary and powerful recruiting and retention tool to maintain and create stockholder value. Non-approval of the Plan Amendment may compel us to increase the cash component of employee compensation because the Company would need to replace components of compensation previously delivered in equity awards.	**FOR**
Proposal 4: Ratification of Selection of Independent Registered Public Accounting Firm (pages 65 to 66) The Board and the Audit Committee believe that the continued retention of PricewaterhouseCoopers LLP for the fiscal year ending December 31, 2019 is in the best interests of the Company and its stockholders. As a matter of good corporate governance, stockholders are being asked to ratify the Audit Committee's selection of the independent registered public accounting firm.	**FOR**

BUSINESS STRATEGY UPDATE AND 2018 BUSINESS RESULTS

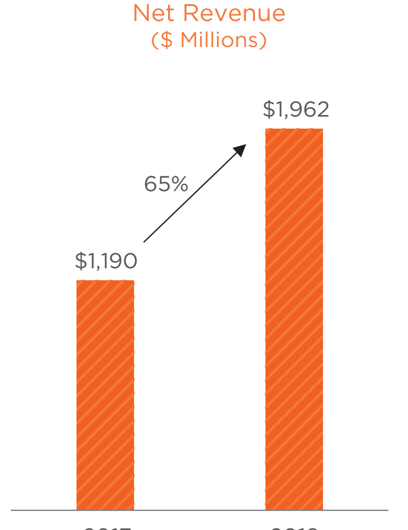
In 2018, we refined our business strategy around three key areas of focus:

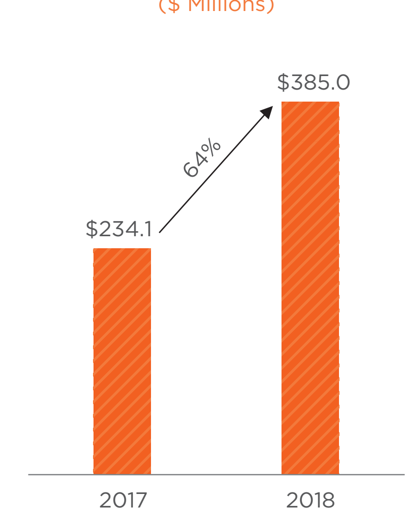
1) driving growth in all three of our segments,
2) delivering substantial cost and revenue synergies from our acquisition of Lifetouch in April 2018, and
3) returning capital to stockholders.

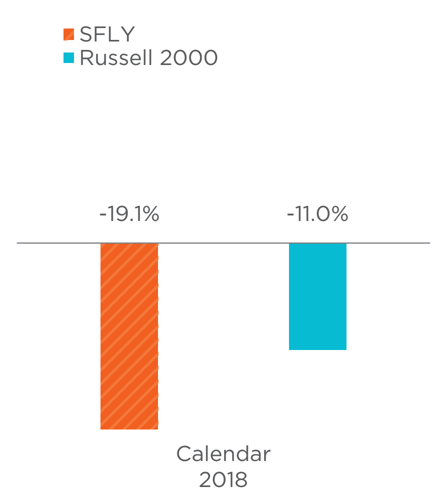
As the first step of our long-term strategy, for the Shutterfly Consumer segment, we will continue to build on our success in mobile, in category and range expansion, and in the reacceleration of personalized gifts and home décor while making improvement in our prints and our holiday cards offering, supported by marketing and promotional investments. For the Lifetouch segment, we aim to drive account growth in schools and preschools and improve our participation rate through awareness supported by direct-to-consumer communications. In the SBS segment, we will continue to focus on servicing our existing large customers and landing large new customers. We believe effectively executing our strategy positions us to deliver sustainable, profitable growth and create value for our stockholders.

As announced by the Company on February 5, 2019, our Board has also formed a Strategic Review Committee and retained a financial advisor as it continues an ongoing review of strategic alternatives. The Board's Strategic Review Committee is also evaluating the Company's capital structure and capital return policy.

Under the leadership of our executive team and in large part due to the integration of Lifetouch, we delivered 65% growth in net revenue and 64% growth in Adjusted EBITDA as compared to 2017. Although we had a transformational year in 2018, with the Lifetouch acquisition and almost doubling the size of the Company and ending 2018 with solid results in the Lifetouch and SBS segments, our aggregate results in 2018 came in below our expectations. Our one-year total stockholder return ("TSR") over calendar year 2018 was (19.1)% compared to (11.0)% for the Russell 2000 index. By continuing to execute our long-term strategy, however, we believe we are well-positioned to create stockholder value moving forward.







* See "Non-GAAP Financial Measures" of this Proxy Statement above for a reconciliation of Adjusted EBITDA, a non-GAAP measure, to net income (loss), the closest comparable GAAP measure.

DIRECTOR NOMINEES AND OTHER DIRECTORS

The following are the Class I Directors who are the nominees for the 2019 Annual Meeting. Christopher North, our President, Chief Executive Officer and Director, is not standing for reelection as he will be stepping down from his role as the Company's President and Chief Executive Officer in the coming months. Effective as of the date of our 2019 Annual Meeting, the size of our Board will be reduced from ten to nine members. For additional information regarding the Shutterfly Board of Directors, please read their biographies which begin on page 9.

	AGE	TITLE	DIRECTOR SINCE	TERM EXPIRATION	INDEPENDENT	AUDIT	COMPENSATION	GOVERNANCE
William J. Lansing	60	Chairman of the Board, Director	2017	2019	Yes			Member
Elizabeth S. Rafael	57	Director	2016	2019	Yes	Chairperson		
Michael P. Zeisser	54	Director	2013	2019	Yes		Member	

The following are the Class II and Class III Directors who will continue on the Board of Directors after the 2019 Annual Meeting.

	AGE	TITLE	DIRECTOR SINCE	TERM EXPIRATION	INDEPENDENT	AUDIT	COMPENSATION	GOVERNANCE
Thomas D. Hughes	59	Director	2015	2021	Yes		Member	Member
Eva Manolis	55	Director	2016	2021	Yes			Member
Elizabeth Sartain	64	Director	2016	2021	Yes		Chairperson	
Ann Mather	58	Director	2013	2020	Yes			
H. Tayloe Stansbury	57	Director	2016	2020	Yes	Member		
Brian T. Swette	65	Director	2009	2020	Yes	Member		Chairperson

– Chairperson – Member

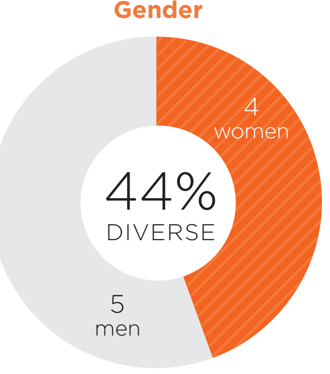
DIRECTOR DASHBOARD

Independence

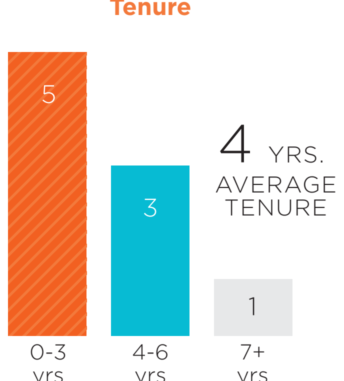
9 independent directors

100% INDEPENDENT

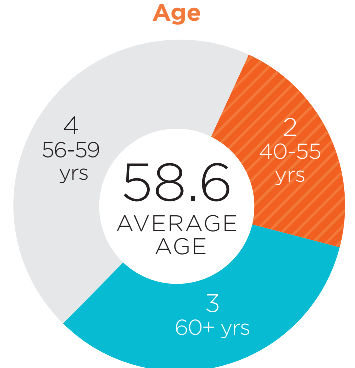
Gender



Tenure



Age



CORPORATE GOVERNANCE/DIRECTOR QUALIFICATIONS

The Corporate Governance at Shutterfly section beginning on page 16 describes our governance practices, which include the following highlights that our Governance Committee takes into consideration when determining whether to recommend a candidate for a position on the Shutterfly Board of Directors:

- character,
- integrity,
- judgment,
- skills,
- business acumen,
- experience,
- commitment,
- diligence,
- conflicts of interest, and the
- ability to act in the interests of all stockholders.

COMPENSATION PROGRAM CHANGES

Our Compensation and Leadership Development Committee (the "Committee") has continued to take steps to redesign our executive compensation program to support our business strategy and in response to ongoing dialogue with our stockholders. In recent years, we have undertaken a robust stockholder engagement program, speaking with stockholders representing over 50% of our outstanding common stock in the past year. These conversations have included our Chairman, CEO, other members of the Board, CFO and other members of senior management, and covered matters of importance to Shutterfly and our stockholders in a variety of areas, including our executive compensation program. We believe changes made to enhance our programs over the last three years have been effective in driving stockholder value creation. For additional information on key feedback and changes, refer to the section titled "Compensation Program Changes" which begins on page 26.

EXECUTIVE COMPENSATION HIGHLIGHTS

Our compensation philosophy provides the guiding principles for structuring our executive compensation program. The objective of our program is to attract, motivate and retain the key executives we need in order to drive stockholder value, fulfill our vision and mission, uphold our values and achieve our corporate objectives. Additional information can be found in the section entitled "Our Corporate Values, Compensation Philosophy, and Practices" which begins on page 29.

- **Compensation Should Reflect our Pay-for-Performance Culture**. We believe a significant portion of executive pay should be directly linked to performance. Accordingly, a significant portion of our executive compensation is contingent on, and varies based on, growth in stockholder value, achievement of our corporate performance goals and individual contributions to our success.
- **Compensation Should Align with Creation of Stockholder Value**. Additionally, we believe that compensation should incentivize management to achieve short-term goals in a manner that also supports a disciplined path toward our longer-term strategic and financial goals. Performance-based cash bonuses create incentives for achieving results that enhance stockholder value in the short-term, while equity awards serve to align the interests of our executives with our stockholders over the long-term. Our compensation policies and practices are designed to balance short-term and long-term interests, and to prevent the opportunity for inappropriate risk-taking that would have a material adverse effect on us.
- **Compensation Level and Mix Should Reflect Responsibility and Accountability**. Total compensation is higher for executives with greater responsibility, greater ability to influence achievement of our corporate goals and greater accountability for those goals. Further, as responsibility increases, a greater portion of the executive's total compensation is performance-based pay and tied to long-term value creation for our stockholders.

Our Executive Compensation Practices

Our executive compensation policies and practices reinforce our pay for performance philosophy and align with sound governance principles. Our executive compensation program is currently composed of three primary elements: base salary; short-term incentive compensation in the form of quarterly performance-based cash bonuses; and long-term incentive compensation in the form of equity awards.

Below are certain highlights of our fiscal 2018 executive compensation policies and practices. Additional information can be found in the section entitled “Our Corporate Values, Compensation Philosophy, and Practices” which begins on page 29.

- **Pay for Performance.** Our program is designed to align executive pay with our financial performance and stockholder value creation.
- **Peer Group Analysis.** The Committee reviews total direct compensation (base salary, annual cash incentive and long-term incentive awards) and the mix of the compensation components for our compensation peer group as one of the factors in determining the compensation for our NEOs.
- **CEO Stock Ownership Policy**. Our CEO is required to hold four times his base salary in our stock, which must be achieved within five years of hire.
- **Use of Independent Compensation Consultant.** The Committee is advised by an independent compensation consulting firm that provides no other services to us.
- **Clawback Policy.** The Committee has adopted a clawback policy applicable to all incentive payments provided to our executive officers.

- **No “Single Trigger” Change-in-Control Payments.** No payments or benefits are payable to our Executives solely on the occurrence of a change-in-control of the company.
- **No Tax Gross-Ups for Excise Taxes.** Our NEOs are not entitled to any tax gross-up payments with respect to excise taxes that may be imposed on certain payments in connection with a change in control.
- **No Hedging, Speculative Trading, or Pledging.** Our trading policies prohibit employees and directors from hedging, speculative trading or pledging of our equity securities.

01

2019
PROXY
STATEMENT

INC

NOTICE OF 2019 ANNUAL MEETING

Meeting Date & Time
Wednesday, May 15, 2019
10:30 a.m. PDT

Meeting Place
1300 Island Drive
Redwood City, California
94065

Record Date
March 18, 2019

DEAR STOCKHOLDER:

Notice is hereby given that the 2019 Annual Meeting of Stockholders (the "Annual Meeting") of Shutterfly, Inc., a Delaware corporation ("we" or "our"), will be held at 1300 Island Drive, Redwood City, California 94065, on May 15, 2019, at 10:30 a.m., Pacific Daylight Time, for the following purposes:

1. To elect three Class I directors to hold office until our 2022 Annual Meeting of Stockholders;
2. To approve, on a non-binding advisory basis, the compensation of our named executive officers as disclosed in the accompanying Proxy Statement;
3. To approve the amendment of our 2015 Equity Incentive Plan to increase the number of shares available for issuance thereunder by 1,000,000 shares and make certain modifications to reflect recent changes in applicable tax laws resulting from the Tax Cuts and Jobs Act of 2017;
4. To ratify the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the year ending December 31, 2019; and
5. To conduct any other business properly brought before the Annual Meeting.

These items of business are more fully described in our Proxy Statement accompanying this Notice (the "Proxy Statement").

Our Board of Directors recommends that you vote FOR the election of the director nominees named in Proposal No. 1; FOR the approval, on a non-binding advisory basis, of the compensation of our named executive officers as disclosed in the accompanying Proxy Statement and described in Proposal No. 2; FOR the amendment of our 2015 Equity Incentive Plan as described in Proposal No. 3; and FOR the ratification of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm as described in Proposal No. 4.

The Board of Directors of Shutterfly, Inc. (the "Board") has fixed the close of business on March 18, 2019 as the record date for the meeting. Only holders of our common stock as of the record date are entitled to notice of and to vote at the meeting and at any adjournment or postponement of the Annual Meeting. Further information regarding voting rights and the matters to be voted upon is presented in this proxy statement.

In accordance with rules promulgated by the Securities and Exchange Commission, we have elected to use the Internet as our primary means of providing our proxy materials to stockholders. On or about April 5, 2019, we mailed to our stockholders a Notice of Internet Availability of Proxy Materials (the "Notice") with instructions for accessing the proxy materials online, including this Proxy Statement and our annual report, as well as for voting in person, by telephone, by mail or via the Internet. The Notice also provides information on how stockholders may obtain paper or email copies of our proxy materials free of charge, if they so choose. The electronic delivery of our proxy materials significantly reduces our printing and mailing costs and the environmental impact of distributing proxy materials.

Your vote is important. Whether or not you plan to attend the Annual Meeting, we encourage you to read the accompanying Proxy Statement and to mark, date, sign and submit your proxy card or voting instructions as soon as possible. For specific instructions on how to vote your shares, please refer to the instructions on the Notice of Internet Availability of Proxy Materials you received in the mail or, if you received printed proxy materials, on the enclosed proxy card.

By Order of the Board of Directors,

Christopher North
President and Chief Executive Officer

Redwood City, California
April 5, 2019

PROXY STATEMENT TABLE OF CONTENTS

2 **QUESTIONS AND ANSWERS ABOUT THE ANNUAL MEETING**

7 **PROPOSAL NO. 1** ELECTION OF DIRECTORS

8 Board of Directors

12 Executive Officers

16 **CORPORATE GOVERNANCE**

21 **SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

23 **SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

24 **PROPOSAL NO. 2** ADVISORY VOTE TO APPROVE THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS

25 **EXECUTIVE COMPENSATION**

25 Compensation Discussion and Analysis

43 **REPORT OF THE COMPENSATION AND LEADERSHIP DEVELOPMENT COMMITTEE OF THE BOARD OF DIRECTORS**

44 **EXECUTIVE COMPENSATION TABLES**

44 Summary Compensation Table

45 Grants of Plan-Based Awards

47 Outstanding Equity Awards at Year-End

48 Option Exercises and Stock Vested

48 CEO Pay Ratio

49 Potential Payments upon Termination or Change of Control

56 **DIRECTOR COMPENSATION**

58 **PROPOSAL NO. 3** AMENDMENT OF 2015 EQUITY INCENTIVE PLAN

67 **PROPOSAL NO. 4** RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

67 Principal Accountant Fees and Services

67 Audit Fees

67 Audit Related Fees

68 Tax Fees

68 All Other Fees

68 Pre-Approval Policies and Procedures

69 **REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS**

70 **CERTAIN TRANSACTIONS**

70 **OTHER MATTERS**

71 **ANNUAL REPORT ON FORM 10-K**

A-1 **APPENDIX A SHUTTERFLY, INC. 2015 EQUITY INCENTIVE PLAN**

SHUTTERFLY, INC.

2800 Bridge Parkway
Redwood City, California 94065

SHUTTERFLY INC

PROXY STATEMENT

The Board of Directors of Shutterfly, Inc. is soliciting your proxy to vote at the Annual Meeting of Stockholders to be held on May 15, 2019, at 10:30 a.m., Pacific Daylight Time, and any adjournment or postponement of that meeting (the "Annual Meeting"). The Annual Meeting will be held at 1300 Island Drive, Redwood City, California 94065. This Proxy Statement and the accompanying Proxy Card, Notice of Meeting, and Annual Report to Stockholders was first sent or made available, on or about April 5, 2019, to stockholders of record as of the close of business on March 18, 2019 (the "Record Date"). For those stockholders receiving a Notice of Internet Availability of Proxy Materials, the Notice of Internet Availability of Proxy Materials was first mailed on or about April 5, 2019 to stockholders of record as of the close of business on the Record Date. The only voting securities of Shutterfly, Inc. are shares of Common Stock, $0.0001 par value per share (the "Common Stock"), of which there were 34,170,027 shares outstanding as of the Record Date (excluding any treasury shares). A majority of the shares of Common Stock outstanding on the Record Date must be present, in person or by proxy, to hold the Annual Meeting.

In this Proxy Statement, we refer to Shutterfly, Inc. as the "Company," "Shutterfly," "we," "our" or "us," and the Board of Directors as the "Board" or "Board of Directors." When we refer to our "fiscal year," or "fiscal" followed by a year, we mean the twelve-month period ending or ended December 31 of the stated year.

Our Annual Report to Stockholders, which contains consolidated financial statements for fiscal 2018, accompanies this Proxy Statement. **You also may obtain a copy of our Annual Report on Form 10-K for fiscal 2018 that was filed with the Securities and Exchange Commission, without charge, by writing to our Investor Relations department at the above address**. Our Annual Report on Form 10-K for fiscal 2018 is also available in the "Investor Relations" section of our website at *ir.shutterfly.com/annual-reports-and-proxies*.

THE PROXY PROCESS AND STOCKHOLDER VOTING

WHO CAN VOTE AT THE ANNUAL MEETING?

Only stockholders of record at the close of business on the Record Date will be entitled to vote at the Annual Meeting. At the close of business on the Record Date, there were 34,170,027 shares of Common Stock outstanding and entitled to vote.

Stockholder of Record: Shares Registered in Your Name

If at the close of business on the Record Date your shares of Common Stock were registered directly in your name with our transfer agent, Computershare Trust Company, N.A., then you are a stockholder of record. As a stockholder of record, you may vote in person at the Annual Meeting or vote by proxy. Whether or not you plan to attend the Annual Meeting, we urge you to complete, sign and return the accompanying proxy card to ensure your vote is counted.

Beneficial Owner: Shares Registered in the Name of a Broker, Bank or Other Agent

If at the close of business on the Record Date, your shares of Common Stock were held in an account at a brokerage firm, bank or other agent rather than in your name, then you are the beneficial owner of shares of Common Stock held in "street name" and these proxy materials are being forwarded to you by your broker, bank or other agent. The broker, bank or other agent holding your account is considered to be the stockholder of record for purposes of voting at the Annual Meeting.

As a beneficial owner, you have the right to instruct your broker, bank or other agent on how to vote the shares of Common Stock in your account. You are also invited to attend the Annual Meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the Annual Meeting unless you request and obtain a valid proxy issued in your name from your broker, bank or other agent.

WHAT AM I BEING ASKED TO VOTE ON?

You are being asked to vote:

- **Proposal No. 1: FOR** the election of three Class I directors to hold office until our 2022 Annual Meeting of Stockholders;
- **Proposal No. 2: FOR** the approval, on a non-binding advisory basis, of the compensation of our named executive officers;
- **Proposal No. 3: FOR** the amendment of our 2015 Equity Incentive Plan to increase the number of shares available for issuance thereunder by 1,000,000 shares and make certain modifications to reflect recent changes in applicable tax laws resulting from the Tax Cuts and Jobs Act of 2017; and
- **Proposal No. 4: FOR** the ratification of the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2019.

WHAT DOES IT MEAN IF I RECEIVE MORE THAN ONE SET OF MATERIALS?

This means you hold shares of Common Stock in more than one way. For example, you may own some shares of Common Stock directly as a "Registered Holder" and other shares of Common Stock through a broker or you may own shares of Common Stock through more than one broker. In these situations, you may receive multiple sets of proxy materials. In order to vote all of the shares of Common Stock you own, you must either sign and return all of the proxy cards or follow the instructions for any alternative voting procedure on each of the proxy cards you receive. Each proxy card you received came with its own prepaid return envelope. If you vote by mail, make sure you return each proxy card in the return envelope which accompanied that proxy card.

DOES MY VOTE MATTER?

YES! We are required to obtain stockholder approval for the election of directors and other important matters. Each share of Common Stock is entitled to one vote and every share voted has the same weight. In order for the Company to obtain the necessary stockholder approval of proposals, a "quorum" of stockholders (i.e., a majority of the

shares entitled to vote at the Annual Meeting, excluding treasury shares) must be represented at the Annual Meeting in person or by proxy. If a quorum is not obtained, we must postpone the Annual Meeting and solicit additional proxies. This is an expensive and time-consuming process that is not in the best interests of the Company or its stockholders. Since few stockholders can spend the time or money to attend stockholder meetings in person, voting by proxy is important to obtain a quorum and complete the stockholder vote.

WHAT IS THE QUORUM REQUIREMENT?

A quorum of stockholders is necessary to hold a valid Annual Meeting. A quorum will be present if at least a majority of the shares of Common Stock entitled to vote at the Annual Meeting, excluding treasury shares, as of the close of business on the Record Date are represented by stockholders present at the Annual Meeting or represented by proxy. At the close of business on the Record Date, there were 34,170,027 shares of Common Stock outstanding and entitled to vote. Therefore, in order for a quorum to exist, 17,085,014 shares of Common Stock must be represented by stockholders present at the meeting or by proxy. Your shares will be counted towards the quorum only if you submit a valid proxy (or one is submitted on your behalf by your broker, bank, or other nominee) or if you vote in person at the Annual Meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, the chairperson of the Annual Meeting or the holders of a majority of the votes present at the Annual Meeting may adjourn the Annual Meeting to another date.

HOW DO I VOTE?

You may vote by mail or follow any alternative voting procedure described on the proxy card. To use an alternative voting procedure, follow the instructions on each proxy card or on the Notice of Internet Availability of Proxy Materials that you receive.

For the election of directors, you may either vote "FOR" the three Class I nominees or you may "WITHHOLD" your vote for any nominee you specify. For the non-binding advisory vote to approve the compensation of our named executive officers, the approval of the amendment to our 2015 Equity Incentive Plan and the ratification of the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2019, you may vote "FOR" or "AGAINST" or abstain from voting. The procedures for voting are as follows:

Stockholder of Record: Shares Registered in Your Name

If you are a stockholder of record, you may vote in person at the Annual Meeting. Alternatively, you may vote by proxy by using the accompanying proxy card, over the Internet or by telephone. Whether or not you plan to attend the Annual Meeting, we urge you to vote by proxy to ensure your vote is counted. Even if you have submitted a proxy before the Annual Meeting, you may still attend the Annual Meeting and vote in person. In such case, your previously submitted proxy will be disregarded.

- To vote using the proxy card, simply complete, sign and date the accompanying proxy card and return it promptly in the envelope provided. If you return your signed proxy card to us before the Annual Meeting, we will vote your shares as you direct.
- To vote over the Internet, go to www.proxyvote.com and follow the instructions to obtain your records and to create an electronic voting instruction form.
- To vote by telephone, call 1-800-690-6903 and follow the instructions to transmit your voting instructions.
- To vote in person, come to the Annual Meeting and we will give you a ballot when you arrive.

Beneficial Owner: Shares Registered in the Name of Broker, Bank or other Agent

If you are a beneficial owner of shares of Common Stock registered in the name of your broker, bank or other agent, you should have received a voting instruction card and voting instructions with these proxy materials from that organization rather than from us. Simply complete and mail the voting instruction card to ensure that your vote is counted. To vote in person at the Annual Meeting, you must obtain a valid proxy from your broker, bank or other agent. Follow the instructions from your broker, bank or other agent included with these proxy materials, or contact your broker, bank or other agent to request a proxy form.

WHO COUNTS THE VOTES?

Broadridge Financial Services, Inc. ("Broadridge") has been engaged as the tabulator of our stockholder votes. A representative of Broadridge will serve as the independent inspector of election to do the final tabulation and certification of stockholder votes.

HOW ARE VOTES COUNTED?

Brokers, banks or other agents who hold shares of Common Stock for the accounts of their clients may vote such shares of Common Stock either as instructed by their clients or in the absence of such instruction, in their own discretion if permitted by the stock exchange or other organization of which they are members. Members of the Nasdaq Stock Market ("Nasdaq") are permitted to vote their clients' proxies in their own discretion as to certain routine proposals, such as the ratification of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for fiscal 2019. If a broker votes shares of Common Stock that are not voted by its clients "For" or "Against" a routine proposal, those shares of Common Stock are considered present and entitled to vote at the Annual Meeting and will be counted toward determining whether or not a quorum is present. Those shares of Common Stock will also be taken into account in determining the outcome of all routine proposals.

Where a proposal is not routine, such as the election of our Class I directors, the non-binding advisory vote to approve the compensation of our named executive officers and the amendment of our 2015 Equity Incentive Plan, a broker does not have discretion to vote its clients' uninstructed shares on such proposals. When a broker indicates on a proxy that it does not have discretionary authority to vote certain shares of Common Stock on a particular proposal, the missing votes are referred to as "Broker Non-votes." Those shares of Common Stock are considered present for the purpose of determining whether or not a quorum is present but are not considered shares of Common Stock entitled to vote or votes cast on a particular proposal and are not taken into account in determining the outcome of non-routine proposals.

Because brokers cannot vote uninstructed shares on behalf of their customers for "non-routine" matters, such as the election of our Class I directors, the non-binding advisory vote to approve the compensation of our named executive officers, and the amendment of our 2015 Equity Incentive Plan, it is more important than ever that stockholders vote their shares of Common Stock. If you do not vote your shares of Common Stock, you will not have a say in these important issues to be presented at the Annual Meeting.

Abstentions, or shares of Common Stock present at the Annual Meeting and voting "Abstain," are counted to determine whether a quorum is present but are not considered votes cast for a particular proposal and are not taken into account in determining the outcome of the matters voted upon at the Annual Meeting.

WHAT ARE THE VOTING REQUIREMENTS TO ELECT THE DIRECTORS AND TO APPROVE EACH OF THE PROPOSALS DISCUSSED IN THIS PROXY STATEMENT?

Proposal No. 1—Election of Directors

Under our Restated Bylaws ("Bylaws") and our Corporate Governance Guidelines, directors must be elected by a majority of the votes cast in uncontested elections. This means that the number of votes cast "For" a director nominee must exceed the number of votes cast "Against" that nominee. Abstentions and broker non-votes are not counted as votes "For" or "Against" a director nominee. In an uncontested election, any nominee who does not receive a majority of votes cast "For" his or her election is required to tender his or her resignation promptly following the failure to receive the required vote. Within 90 days following certification of the stockholder vote, the Governance Committee of the Board is required to make a recommendation to the Board as to whether it should accept such resignation. Thereafter, the Board is required to decide whether to accept such resignation. In contested elections, the required vote would be a plurality of votes cast.

Proposal No. 2—Non-Binding Advisory Vote to Approve the Compensation of our Named Executive Officers

Under our Bylaws, the votes cast "For" must exceed the votes cast "Against" to approve, on an advisory basis, the compensation of our named executive officers. Abstentions and broker non-votes are not counted as votes "For" or "Against" this proposal.

Proposal No. 3—Amendment of 2015 Equity Incentive Plan

Under our Bylaws, the votes cast "For" must exceed the votes cast "Against" to approve the amendment of our 2015 Equity Incentive Plan. Abstentions and broker non-votes are not counted as votes "For" or "Against" this proposal.

Proposal No. 4—Ratification of PricewaterhouseCoopers LLP

Under our Bylaws, the votes cast "For" must exceed the votes cast "Against" to approve the ratification of PricewaterhouseCoopers LLP as our independent registered public accounting firm for fiscal 2019. The vote to approve the ratification of

our independent registered public accounting firm is considered a routine proposal, and therefore if your shares of Common Stock are held by your broker, bank or other agent and you do not provide voting instructions and the broker, bank or other agent has discretionary authority to vote such shares of Common Stock, your shares of Common Stock may be voted at the discretion of the broker, bank or other agent. Abstentions are not counted as votes "For" or "Against" this proposal.

HOW DO I VOTE BY INTERNET OR TELEPHONE?

If you wish to vote by Internet, go to www.proxyvote.com and follow the instructions to obtain your records and to create an electronic voting instruction form. If you wish to vote by telephone, call 1-800-690-6903 and follow the instructions to transmit your voting instructions. Please have your proxy card in hand when you vote over the Internet or by telephone. The Internet and telephone voting availability will close at 11:59 p.m., Eastern Daylight Time on May 14, 2019. The giving of such a telephonic or Internet proxy will not affect your right to vote in person should you decide to attend the Annual Meeting.

The telephone and Internet voting procedures are designed to authenticate stockholders' identities, to allow stockholders to give their voting instructions and to confirm that stockholders' instructions have been recorded properly.

HOW MANY VOTES DO I HAVE?

On each matter to be voted upon, you have one vote for each share of Common Stock you owned as of the close of business on the Record Date.

WHAT IF I RETURN A PROXY CARD BUT DO NOT MAKE SPECIFIC CHOICES?

If you return a signed and dated proxy card but you do not indicate your voting preferences, your shares of Common Stock will be voted in the manner recommended by the Board on all matters presented in this Proxy Statement and as the proxy holders may determine in their discretion with respect to any other matters properly presented for a vote at the Annual Meeting.

CAN I CHANGE MY VOTE AFTER SUBMITTING MY PROXY?

Yes. You can revoke your proxy at any time before the applicable vote at the Annual Meeting. If you are the stockholder as of the close of business on the Record Date, you may revoke your proxy in any one of three ways:

- you may submit another properly completed proxy with a later date;
- you may send a written notice that you are revoking your proxy to our Corporate Secretary at 2800 Bridge Parkway, Redwood City, California 94065; or
- you may attend the Annual Meeting and give notice to the Inspector of Election that you intend to vote your shares in person.

If you are the beneficial owner of shares of Common Stock held in street name by your broker, bank, or other agent, then you should follow the instructions they provide on how to vote the shares of Common Stock in your account.

WHO IS SOLICITING MY PROXY AND PAYING FOR THIS PROXY SOLICITATION?

Our Board of Directors is soliciting your proxy to vote. We will pay the entire cost of preparing, assembling, printing, mailing, and distributing these proxy materials. We will also bear the cost of soliciting proxies on behalf of the Board. We have also retained MacKenzie Partners, Inc. to assist in the solicitation of proxies for a fee of up to $50,000 plus the reimbursement of out-of-pocket expenses incurred on behalf of Shutterfly.

We will provide copies of these proxy materials to banks, brokerage houses, fiduciaries, and custodians holding shares of our Common Stock beneficially owned by others in street name so that they may forward these proxy materials to the beneficial owners.

In addition to mailing proxy materials, our directors, officers and employees may also solicit proxies in person, by telephone, or by other means of communication. Directors, officers and employees will not be paid any additional compensation for soliciting proxies. We may also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners.

In addition, we may reimburse brokerage firms and other persons representing beneficial owners of shares of Common Stock for their expenses in forwarding solicitation materials to such beneficial owners.

HOW CAN I FIND OUT THE RESULTS OF THE VOTING AT THE ANNUAL MEETING?

Voting results will be announced by the filing of a Current Report on Form 8-K within four business days after the day the Annual Meeting ends. If final voting results are unavailable at that time, we will file an amended Current Report on Form 8-K within four business days after the day final results are available.

WHEN ARE STOCKHOLDER PROPOSALS DUE FOR NEXT YEAR'S ANNUAL MEETING OF STOCKHOLDERS?

To be considered for inclusion in next year's proxy materials, a stockholder proposal must be submitted in writing to our Corporate Secretary at 2800 Bridge Parkway, Redwood City, California 94065 no later than December 6, 2019. If you wish to submit a proposal for consideration at our 2019 Annual Meeting but not for inclusion in our proxy statement for that meeting, your proposal must be submitted in writing to the same address no earlier than January 31, 2020 and no later than the close of business on March 1, 2020. Please review our Bylaws, which contain additional requirements regarding advance notice of stockholder proposals.

HOW DO I ATTEND THE ANNUAL MEETING AND VOTE IN PERSON?

You are cordially invited to attend the Annual Meeting to be held at 1300 Island Drive, Redwood City, California 94065, on May 15, 2019, at 10:30 a.m., Pacific Daylight Time. Attendance at the Annual Meeting will be limited to Shutterfly stockholders as of the close of business on the Record Date. It is important that you let us know in advance whether you plan to attend the Annual Meeting by marking the appropriate box on your proxy card if you requested to receive printed proxy materials, or, if you vote by telephone or Internet, indicating your plans when prompted. You will be required to check-in and register before being admitted to the Annual Meeting. Check-in and registration will begin promptly at 10:00 a.m., Pacific Daylight Time, at 1300 Island Drive, Redwood City, California 94065. Admission will be on a first-come, first-served basis. Please allow ample time for check-in. Photography and video recording are prohibited at the Annual Meeting.

Each stockholder should be prepared to present valid photo identification, such as a driver's license or passport and stockholders holding their shares of Common Stock through a broker, bank or other agent will need to bring proof of beneficial ownership as of the Record Date, such as their most recent account statement reflecting their Common Stock ownership prior to the Record Date, a copy of the voting instruction card provided by their broker, bank, or other agent, or similar evidence of ownership.

If you are a stockholder as of the close of business on the Record Date and wish to vote in person, we will provide you with a ballot to use to vote at the Annual Meeting. If you are a beneficial owner, like a vast majority of our stockholders, and hold shares of Common Stock through a broker, bank or other agent, you may not vote your shares of Common Stock in person at the Annual Meeting unless you obtain a "legal proxy" from the broker, bank or other agent that holds your shares of Common Stock giving you the right to vote the shares of Common Stock at the Annual Meeting. **Even if you plan to attend the Annual Meeting, we recommend that you also submit your proxy or voting instructions as described in the Proxy Statement so that your vote will be counted if you later decide not to attend the Annual Meeting**.

PROPOSAL NO. 1 ELECTION OF DIRECTORS

Our Board of Directors is presently composed of ten members, nine of whom are currently independent directors within the meaning of the listing standards of Nasdaq. Our Certificate of Incorporation and Bylaws provide for the Board to be divided into three classes. Each class serves for a three-year term. At the 2019 Annual Meeting of stockholders, three Class I directors are to be elected to serve until our 2022 annual meeting of stockholders, and until their successors are elected and qualified. The terms of our three Class II directors and three Class III directors expire at our 2020 and 2021 annual meetings of stockholders, respectively. Christopher North, our Chief Executive Officer and Director, is not standing for reelection as he will be stepping down from his role as the Company's President and Chief Executive Officer in the coming months. Effective as of the close of our 2019 Annual Meeting, the size of our Board will be reduced from ten to nine members.

The three Class I director nominees are:

William J. Lansing
Elizabeth S. Rafael
Michael P. Zeisser

Each of the nominees is currently a member of our Board. The Board appointed Mr. Lansing in February 2017. Mr. Zeisser and Ms. Rafael were previously elected at the 2013 and 2016 annual meetings of stockholders, respectively. Each of the nominees has been recommended by the Governance Committee of the Board (the "Governance Committee") and was approved by the Board. In addition, each of the nominees has consented to serve as a nominee and to be named as a nominee in this Proxy Statement, and to serve as a director if elected.

Under our Bylaws and newly adopted Corporate Governance Guidelines, a majority of votes cast is required for the election of directors in an uncontested election (which is the case for the election of directors at the Annual Meeting). A majority of the votes cast means that the number of votes cast "For" a director nominee must exceed the number of votes cast "Against" that nominee. In contested elections (an election in which the number of nominees for election as director is greater than the number of directors to be elected), the voting standard would be a plurality of the votes cast.

In accordance with our Corporate Governance Guidelines, the Board will nominate for election only candidates who agree, if elected, to tender, promptly following their failure to receive the required vote for election at the next annual meeting of stockholders at which they would stand for election, an irrevocable resignation that will be effective upon acceptance by the Board. In addition, the Board will fill director vacancies and new directorships only with candidates who agree to tender the same form of resignation promptly following their election to the Board.

If an incumbent director fails to receive the required vote for election, then, within 90 days following certification of the stockholder vote, the Governance Committee will act to determine whether to recommend acceptance of the director's resignation and will submit the recommendation for prompt consideration by the Board, and the Board will act on the Governance Committee's recommendation.

Our Board is currently composed of a group of leaders with broad and diverse experience in many fields, including management of large global consumer brands, technology and innovation leadership, financial services, and corporate governance and compliance. In these positions, they have also gained significant and diverse management experience, including industry knowledge, strategic financial planning, public company financial reporting, compliance, risk management and leadership development. Many of the directors also have experience serving as executive officers, or on board of directors and board committees of other public companies and understand corporate governance practices and trends. The biographies of the nominees describe the skills, qualities, attributes and experiences of each of the nominees that led the Board to determine that it is appropriate to nominate these directors.

The Governance Committee and the Board believe the skills, qualities, attributes and experiences of its current directors and director nominees provide Shutterfly with a diverse range of perspectives and business acumen and allow our directors to effectively engage each other and management to effectively address our evolving needs and represent the best interests of our stockholders.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF EACH NOMINEE

BOARD OF DIRECTORS

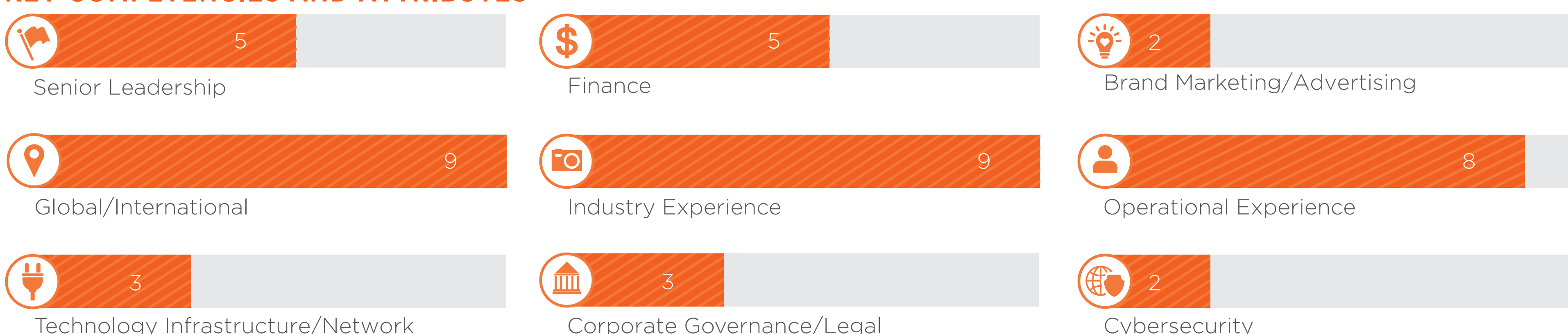
The following is biographical information as of April 5, 2019 for each Class I director nominee, William J. Lansing, Elizabeth S. Rafael and Michael P. Zeisser, and each person whose term of office as a Class II or III director will continue after the Annual Meeting.

	AGE	TITLE	INDEPENDENT	AUDIT	COMPENSATION	GOVERNANCE
William J. Lansing	60	Chairman of the Board, Director	Yes			Member
Thomas D. Hughes	59	Director	Yes		Member	Member
Eva Manolis	55	Director	Yes			Member
Ann Mather	58	Director	Yes			
Elizabeth S. Rafael	57	Director	Yes	Chairperson		
Elizabeth Sartain	64	Director	Yes		Chairperson	
H. Tayloe Stansbury	57	Director	Yes	Member		
Brian T. Swette	65	Director	Yes	Member		Chairperson
Michael P. Zeisser	54	Director	Yes		Member	

= Chairperson   = Member

Below are certain key competencies and attributes represented on our Board. More details on each Director's competencies are included in the Director profiles which follows.

KEY COMPETENCIES AND ATTRIBUTES



WILLIAM J. LANSING

Age: 60

Director since: 2017

EXPERIENCE: William J. Lansing has served on our Board of Directors as the Chairman of the Board since February 2017. Mr. Lansing has more than 30 years of strategic and operational experience, helping technology and consumer businesses innovate and drive growth. Since 2012, Mr. Lansing has served as the Chief Executive Officer of FICO, a data analytics company, where he also served as a director since 2006. Previous to his role with FICO, Mr. Lansing served as Chief Executive Officer and President of InfoSpace, Inc. (now Blucora), an Internet search company, and ValueVision Media (now Evine), a broadcast television company. Mr. Lansing also served as a Partner of General Atlantic Partners, a global private equity investment firm. Prior to his work at General Atlantic Partners, Mr. Lansing served as Chief Executive Officer of NBC Internet, an integrated Internet media company. Mr. Lansing also held several leadership positions in organizations including Fingerhut Companies, General Electric, Prodigy and McKinsey & Company. Previously, Mr. Lansing served on the board of directors of Digital River, a payment services company, and RightNow Technologies, a CRM software company that was subsequently acquired by Oracle Corporation.

QUALIFICATIONS: Mr. Lansing received a Bachelor of Arts from Wesleyan University and a Juris Doctor from Georgetown University. Mr. Lansing brings to the Board extensive knowledge of operating a public company in the technology sector and diverse business experience.

ELIZABETH S. RAFAEL

Age: 57

Director since: 2016

EXPERIENCE: Elizabeth S. Rafael has served on our Board of Directors since June 2016. Since May 2018, Ms. Rafael has served as the Chief Transformation Officer of GoDaddy Inc., an Internet domain register and web hosting company. Ms. Rafael served as Principal Accounting Officer of Apple Inc., a consumer technology company, from January 2008 to October 2012, and as its Vice President and Corporate Controller from August 2007 until October 2012. From April 2002 to September 2006, Ms. Rafael served as Vice President, Corporate Controller and Principal Accounting Officer of Cisco Systems, Inc., a multinational technology company, and subsequently held the position of Vice President, Corporate Finance from September 2006 to August 2007. From December 2000 to April 2002, Ms. Rafael was the Executive Vice President, Chief Financial Officer, and Chief Administrative Officer of Aspect Communications, Inc., a provider of customer relationship portals. From April 2000 to November 2000, Ms. Rafael was Senior Vice-President and CFO of Escalate, Inc., an enterprise e-commerce application service provider. From 1994 to 2000, Ms. Rafael held a number of senior positions at Silicon Graphics International Corp. (“SGI”), a computing solutions company, culminating her career at SGI as Senior Vice President and Chief Financial Officer. Prior to SGI, Ms. Rafael held senior management positions in finance with Sun Microsystems, Inc. and Apple Computers. Ms. Rafael began her career with Arthur Young & Company (now Ernst & Young). Ms. Rafael has served on the board of directors of Echelon Corporation, a control networking company, since November 2005, and Autodesk, Inc., a multinational software company, since September 2013, and previously served on the board of directors of GoDaddy Inc. and PalmSource, Inc.

QUALIFICATIONS: Ms. Rafael holds a Bachelor of Science degree in accounting from Santa Clara University. Ms. Rafael brings over 30 years of financial experience and expertise to our Board and significant experience in the technology industry.

MICHAEL P. ZEISSER

Age: 54

Director since: 2013

EXPERIENCE: Michael P. Zeisser has served on our Board of Directors since March 2013. Mr. Zeisser served as Chairman, US Investments for Alibaba Group Holding Ltd., one of the largest Internet companies in the world, until March 2018. Prior to Alibaba, Mr. Zeisser served as Senior Vice President of Liberty Interactive Corporation (formerly known as Liberty Media Corporation), a digital media and Internet commerce company, from September 2003 to November 2012 where he oversaw consumer-facing Internet and e-commerce investments and companies. Prior to his tenure at Liberty, Mr. Zeisser was a partner at McKinsey & Company, a global management consulting firm, from December 1996 to September 2003. During the past six years Mr. Zeisser has served as a member of the boards of directors of Time, Inc., a media company, TripAdvisor, Inc., a travel website company, IAC/Interactive Corp, a digital media and eCommerce company and XO Group, Inc., a consumer Internet company.

QUALIFICATIONS: Mr. Zeisser graduated from the University of Strasbourg, France and the J.L. Kellogg Graduate School of Management at Northwestern University. Mr. Zeisser is currently a member of the Media Advisory Group of the American Association for the Advancement of Science. Mr. Zeisser has extensive insight into, and unique and specialized experience regarding, the Internet and digital media. He also possesses significant experience with respect to international operations and business strategy.

ANN MATHER

Age: 58

Director since: 2013

EXPERIENCE: Ann Mather has served on our Board of Directors since May 2013. Ms. Mather has been a director of Glu Mobile Inc., a mobile phone games publisher, since September 2005, Alphabet, Inc., a technology company, since November 2005, MGM Holdings Inc., a media production and distribution company, since December 2010, Netflix, Inc., a media company, since July 2010, and Arista Networks, Inc., a computer networking company, since June 2013. Since 2011, Ms. Mather has been an independent trustee to the Dodge & Cox Funds, a mutual fund company, board of trustees. Ms. Mather serves as the audit committee chair for Alphabet, Netflix and Arista Networks. From 1999 to 2004, Ms. Mather was Executive Vice President and Chief Financial Officer of Pixar, a computer animation studio where she was responsible for finance, administration, business affairs, investor relations and human resources. Prior to her service at Pixar, Ms. Mather was Executive Vice President and Chief Financial Officer at Village Roadshow Pictures, the film production division of Village Roadshow Limited. Ms. Mather also held a senior financial executive position with Disney, a multinational mass media and entertainment conglomerate.

QUALIFICATIONS: Ms. Mather holds a Master of Arts degree from Cambridge University. Ms. Mather brings executive and financial experience to our Board and her service on other public company boards provides considerable experience that contributes to our Board's overall effectiveness.

H. TAYLOE STANSBURY

Age: 57

Director since: 2016

EXPERIENCE: H. Tayloe Stansbury has served on our Board of Directors since December 2016. Mr. Stansbury has more than 35 years of experience at various technology companies. Most recently, Mr. Stansbury served as Executive Vice President and Chief Technology Officer at Intuit, a business and financial software company. He previously served as Chief Information Officer at VMware, Inc., which subsequently became a subsidiary of Dell Technologies. Mr. Stansbury previously was Executive Vice President of Ariba Inc., an information technology company, which was subsequently acquired by SAP, where he led product management, engineering, hosting and customer support. He has also previously held executive engineering and general management roles at Calico Commerce, Inc., which was ultimately acquired by Oracle Corporation, and Xerox Corporation. Mr. Stansbury has served on the board of directors of BlueJeans Network, a cloud-based videoconferencing company, since October 2018; has served on the board of directors of Coupa Software Inc., a cloud-based platform for business spend, since September 2015; and previously served on the boards of directors for several nonprofit organizations.

QUALIFICATIONS: Mr. Stansbury holds an A.B. with honors in Applied Mathematics from Harvard University. Mr. Stansbury brings to the Board his experience building scalable technology platforms and large organizations at many companies.

BRIAN T. SWETTE

Age: 65

Director since: 2009

EXPERIENCE: Brian T. Swette has served on our Board of Directors since September 2009 and as Interim Chairman of the Board from June 2016 through February 2017. Mr. Swette served as a director of Burger King Holdings, Inc., the world's second largest fast food hamburger restaurant chain, from 2002 to 2011 and served as Burger King's Non-Executive Chairman from 2006 to 2011. Previously, he served as the Chief Operating Officer of eBay Inc., an online commerce company, from 1998 to 2002. Prior to eBay, Mr. Swette was Executive Vice President and Chief Marketing Officer of Pepsi-Cola (now PepsiCo Inc.). Mr. Swette currently serves as the President of Sweet Earth Natural Foods, a food & beverage company that specializes in handcrafted vegetarian foods. Mr. Swette also served on the board of directors of Care.com, Inc., an Internet care services company, as well as on the boards of directors of privately held companies. From 2006 to 2014, Mr. Swette previously served on the board of directors of Jamba, Inc., a retail beverage company. Mr. Swette holds a Bachelor of Science degree in Economics from Arizona State University.

QUALIFICATIONS: Mr. Swette brings to the Board his marketing, strategy and management experience as well as significant knowledge of Internet companies and consumer industries. In addition to his marketing skills, Mr. Swette's experience building fast-growth e-commerce businesses brings a unique and relevant perspective to our Board and management.

THOMAS D. HUGHES

Age: 59

Director since: 2015

EXPERIENCE: Thomas D. Hughes has served on our Board of Directors since July 2015. Mr. Hughes currently serves as a Partner of Cedar Grove Investments, LLC, an early-stage venture firm. From September 2013 to October 2014, Mr. Hughes served as the Vice President of Yahoo, where he ran Flickr, an image hosting and video hosting website. From 1991 to 1998, Mr. Hughes founded and served as President of PhotoDisc, Inc. which was acquired by Getty Images, Inc. in 1998, he was employed by Getty Images through 1999. Prior to PhotoDisc, he served as President of Northshore Publishing Systems, Inc., a publishing industry systems Integrator from 1984 to 1991. Mr. Hughes previously served as a member of the Boards of Directors or as an advisor to the Boards of Directors of; Loudeye, Inc., an encoding company that was later sold to Nokia, from 1999 to 2001, Avenue A, Inc./aQuantive, an online advertising, planning and metrics-based media firm that was later sold to Microsoft Corp., from 1998 to 2001, Vacationspot.com, an ecommerce vacation-booking site, that was later sold to Expedia, from 1998 to 2001, Avolo.com, an aerospace industry exchange, from 2000 to 2003, and RPI Print Inc., a producer of on-demand private-label personalized photo books, greeting cards and stationery for retailers, from July 2011 to September 2013.

QUALIFICATIONS: Mr. Hughes received a Bachelor of Arts in History from the University of Washington. Mr. Hughes brings experience from the photo and publishing industry providing important insights and guidance to our Board.

EVA MANOLIS

Age: 55

Director since: 2016

EXPERIENCE: Eva Manolis has served on our Board of Directors since October 2016. For over ten years prior to joining our Board, Ms. Manolis served as Vice President of Consumer Shopping Experience at Amazon.com, Inc., an electronic commerce and cloud-computing company, where she led the worldwide development of core consumer-facing features, functionality and user interface designs across multiple websites, mobile apps, and business lines. She further led cross-company initiatives around customer experience, design and innovation. Prior to joining Amazon.com, Ms. Manolis was the co-founder and Senior Vice President of Products at Shutterfly. Ms. Manolis has also held roles at KeepMedia, LivePicture Inc. and Silicon Graphics. Ms. Manolis has served on the board of FICO, a data analytics company, since April 2018. She holds 22 patents issued in the areas of imaging, operating systems, and user interaction.

QUALIFICATIONS: Ms. Manolis brings to the Board more than 30 years of experience leading product and engineering teams, designing and building innovative customer products and services in the technology industry. Ms. Manolis earned a Bachelor of Science and Master of Science degrees in Electrical Engineering from Brown University.

ELIZABETH SARTAIN

Age: 64

Director since: 2016

EXPERIENCE: Elizabeth Sartain has served on our Board of Directors since December 2016. Ms. Sartain has over 30 years of experience as a senior human resources leader in the technology, media, consumer products, professional services, and manufacturing industries. Since 2008, Ms. Sartain has served as a Principal at Libby Sartain LLC, an independent human resources advisory and consultancy firm. Ms. Sartain previously served as Chief People Officer at Yahoo! Inc., a multinational technology company, from 2001 to 2008, and as the Vice President of People at Southwest Airlines, an airline carrier, from 1988 until 2001 where she led all human resources functions including employment, development and training, benefits, compensation, and employee relations and compliance. Ms. Sartain has served on the board of directors of ManpowerGroup Inc., a multinational human resource consulting firm, since 2010 and AARP, Inc., a senior citizen advocacy group, since June 2014, and previously served on the board of directors of Peet's Coffee & Tea, Inc. Ms. Sartain holds Master of Business Administration from the University of North Texas and a Bachelor of Business Administration from Southern Methodist University.

QUALIFICATIONS: Ms. Sartain brings to the Board significant and diverse human resources expertise and general business experience.

EXECUTIVE OFFICERS

The following is biographical information for our executive officers as of April 5, 2019.

NAME	AGE	POSITION
Christopher North	48	President and Chief Executive Officer
James A. Hilt	43	President, Shutterfly Consumer
Michael Meek	56	President and Chief Executive Officer, Lifetouch
Scott Arnold	55	President, Shutterfly Enterprise
Dwayne Black	51	Senior Vice President and Chief Operations Officer
Greg Hintz	40	Senior Vice President, Corporate Development
Tracy Layney	46	Senior Vice President and Chief Human Resources Officer
Ishantha Lokuge	52	Senior Vice President and Chief Product Officer
Satish Menon	61	Senior Vice President and Chief Technology Officer
Maureen Mericle	52	Senior Vice President and Chief Marketing Officer
Michael Pope	52	Senior Vice President and Chief Financial Officer

CHRISTOPHER NORTH

Age: 48

Director since: 2016

EXPERIENCE: Christopher North has served as our President and Chief Executive Officer since May 2016. He has served on our Board of Directors since May 2016 and will continue to serve until the end of the Annual Meeting. Mr. North was employed by Amazon.com, Inc. from 2006 to May 2016. Mr. North served as Amazon's UK Country Manager from January 2011, initially as Managing Director of Amazon.co.uk Ltd. until May 2015 and then as UK Managing Director of Amazon EU Sarl until May 2016. Prior to January 2011, he served as Vice President, UK Media, and prior to that role, as Vice President, UK Books at Amazon. Prior to joining Amazon, Mr. North served as Managing Director of Phaidon Press Ltd., as Chief Operating Officer at HarperCollins Canada Ltd., as Vice President and General Manager, Electronic Publishing at HarperCollins Publishers, and as a management consultant at Booz Allen Hamilton.

Mr. North received a Bachelor of Arts in Economics from Harvard College and a Master of Arts in Philosophy from New York University.

JAMES A. HILT

Age: 43

Executive Officer since: 2019

EXPERIENCE: James A. Hilt has served as our President, Shutterfly Consumer since March 2019. Prior to Shutterfly, Mr. Hilt served from April 2018 to March 2019 as Executive Vice President and Chief Customer Experience Officer of Express, Inc., an American fashion retailer. Prior to that, he served Express as Executive Vice President, Chief Marketing Officer and eCommerce from March 2016 to April 2018, as Executive Vice President, eCommerce from March 2015 to February 2016, and as Senior Vice President, eCommerce from February 2014 to February 2015. Prior to joining Express, he was the Vice President of eBooks and Managing Director, International at Barnes & Noble, Inc. from May 2011 to February 2014. Prior to that, Mr. Hilt held several executive positions at Sears Holdings Corporation, the parent company of Sears and Kmart, including Divisional Vice President of Product Management, Divisional Vice President of Online Services and Divisional Vice President and Director of ManageMyHome. Prior to Sears, Mr. Hilt was a Director of Global Marketing at SAP America, Inc. Before joining SAP, Mr. Hilt held several senior positions at International Business Machines Corporation. Mr. Hilt serves on the board of Hibbett Sports, Inc., a leading athletic-inspired fashion retailer.

Mr. Hilt holds a Bachelor of Arts in Political Science from University of Minnesota.

MICHAEL MEEK

Age: 56

Executive Officer since: 2018

EXPERIENCE: Michael Meek has served as our President and Chief Executive Officer of Lifetouch since July 2016. He also has served on the Lifetouch Board of Directors since 2014. Lifetouch was acquired by Shutterfly, Inc. in April 2018. From December 2013 to July 2016, he served as President and Chief Operating Officer of Lifetouch. From May 2010 to December 2013, he served as President and Chief Operating Officer of Lifetouch Portrait Studios Inc., a wholly owned subsidiary of Lifetouch. From June 2008 to May 2010, he served as Vice President of Business Development of Lifetouch Portrait Studios Inc. Prior to 2008, Mr. Meek held sales, merchandising and operations management roles for Nordstrom, Target, Macy's Inc., and Marshall Field's, all of which are retail companies.

SCOTT ARNOLD

Age: 55

Executive Officer since: 2017

EXPERIENCE: Scott Arnold has served as our President, Shutterfly Enterprise since June 2017. Prior to Shutterfly, Mr. Arnold served from May 2013 to April 2016 as President and Chief Executive Officer at AppSense, a leading provider of user environment management solutions enabling a productive, secure workspace. Prior to AppSense, from July 2007 to August 2012, Mr. Arnold held the roles of Chief Operating Officer and then President and Chief Executive Officer of MarketTools, Inc., an internet-based market research company, and Chief Operating Officer and then Interim Chief Executive Officer of Borland Software, a software company that facilitates software development projects. Prior to his operating roles, Mr. Arnold was a partner at McKinsey & Company where he served clients across the technology and telecom industries and helped build the Firm's practice in Silicon Valley. Mr. Arnold currently serves on Duke University's Pratt School of Engineering Board of Visitors.

Mr. Arnold holds a Bachelor of Science in Electrical Engineering from Duke University and an MBA from the Stanford Graduate School of Business.

DWAYNE BLACK

Age: 51

Executive Officer since: 2007

EXPERIENCE: Dwayne Black has served as our Senior Vice President and Chief Operations Officer since February 2007. Prior to joining Shutterfly, Mr. Black held multiple positions at Banta Corporation, a leading provider of printing and digital imaging solutions to publishers and direct marketers owned by R.R. Donnelley and Sons Co., including Vice President of Operations, from 1994 to 2006.

Mr. Black attended the Engineering program at Purdue University.

GREG HINTZ

Age: 40

Executive Officer since: 2019

EXPERIENCE: Greg Hintz has served as our Senior Vice President, Corporate Development since March 2019. From June 2017 to March 2019, he served as our Vice President, Corporate Development and Chief of Staff. From February 2015 to March 2016, he served as Vice President, Strategy and Corporate Development and Interim GM of Shutterfly Business Solutions. From January 2012 to February 2015, he served as Vice President and General Manager of Tiny Prints, Inc., a business unit of Shutterfly. From April 2011 to November 2011, he served as General Manager of Yidio LLC, an online streaming video guide. From January 2008 to April 2011, he served in various senior roles at Yahoo! Inc., a webservices provider.

Mr. Hintz holds a Bachelor of Arts degree in Economics from Yale University.

TRACY LAYNEY

Age: 46

Executive Officer since: 2015

EXPERIENCE: Tracy Layney has served as our Senior Vice President and Chief Human Resources Officer since June 2015 and additionally oversees the Shutterfly Foundation. Prior to joining Shutterfly, from 2004 to 2014, Ms. Layney held various HR roles at Gap Inc., a retail apparel company. Most recently, she served as Senior Vice President of Global Human Resources and Communications at Old Navy, and before that as Vice President of Global HR Strategy, Technology and Operations. From 2003 to 2004, Ms. Layney served as Senior Organization Readiness Manager at Levi Strauss & Company, a retail apparel company, and from 1999 to 2003, she served as a Principal Consultant in the Organization and Change Strategy practice at PricewaterhouseCoopers/IBM Business Consulting Services, the consulting division of IBM.

Ms. Layney holds a Bachelor of Arts degree in English from the University of Pennsylvania.

ISHANTHA LOKUGE

Age: 52

Executive Officer: 2012

EXPERIENCE: Ishantha Lokuge has served as our Senior Vice President and Chief Product Officer since July 2012. Previously, Mr. Lokuge was Vice President of Product at Shutterfly. Mr. Lokuge joined Shutterfly in 2006 as Senior Director of User Experience. Prior to joining Shutterfly, from 2003 to 2006, Mr. Lokuge served as a Director at eBay, Inc. where he led the Selling Experience team. From 2000 to 2002, Mr. Lokuge served as Chief Executive Officer and cofounder of Urbanpixel, an integrated social networking company. From 1996 to 2000, Mr. Lokuge held operational roles at Healtheon/WebMD, an online medical information source, at Netscape, a computer services company, and Silicon Graphics, Inc., a computer hardware and software company.

Mr. Lokuge earned his Master of Media Arts and Sciences degree from the MIT Media Lab, a Master of Science degree in Computer Science from Tufts University, and a Bachelor of Arts degree in Computer Science from Brandeis University.

SATISH MENON

Age: 61

Executive Officer since: 2014

EXPERIENCE: Satish Menon has served as our Senior Vice President and Chief Technical Officer since November 2014. Dr. Menon joined Shutterfly from UV Labs, a technology incubator, where he served as Chief Executive Officer from December 2012 to October 2014. Prior to UV Labs, from 2009 to November 2012, Dr. Menon was the Senior Vice President and Chief Technical Officer of Apollo Education Group, Inc., an educational services and support company. From 2006 to 2009, Dr. Menon served as Vice President of the Consumer Platforms Group at Yahoo! Inc.. Dr. Menon also held technology leadership positions at Kasenna, Inc., a video on demand company, from 2000 to 2006 and as Director of Software Technology at Silicon Graphics, Inc. from 1994 to 2000. Dr. Menon has served on the Scientific Advisory Board of MedGenome Labs Pvt Ltd, a provider of clinical genomics solutions for personalized healthcare, since November 2012.

Dr. Menon holds a Ph.D. in Computer Science from Georgia Institute of Technology, Master of Science degrees in Computer Science and Mechanical Engineering from New Jersey Institute of Technology and a Bachelor of Science degree in Mechanical Engineering from the University of Calicut, India.

MAUREEN MERICLE

Age: 52

Executive Officer since: 2018

EXPERIENCE: Maureen (Mickey) Mericle has served as our Senior Vice President and Chief Marketing Officer since October 2018. From August 2015 to October 2018, she served as Vice President, Adobe Global Marketing of Adobe Inc., a computer software company. From September 2010 to August 2015, she served Walmart Inc., a retail company, as Vice President and Officer, Marketing, and from September 2009 to September 2010, she served as Senior Director, Strategy. From March 2004 to June 2009, she served Target Corporation, a retail company, in several marketing roles. Other employment experience includes Monitor Company, Kinko's, and the State Department.

Ms. Mericle holds a B.A. from Iowa State University, an M.S. (Economics) from the University of Pennsylvania, and an MBA from the Kellogg School of Management at Northwestern University.

MICHAEL POPE

Age: 52

Executive Officer since: 2015

EXPERIENCE: Michael Pope has served as our Senior Vice President and Chief Financial Officer since October 2015. Previously, from 2013 to 2015, Mr. Pope served as Chief Financial Officer of Clean Power Finance, a residential solar power financing company. From 2008 to 2012, Mr. Pope held the positions of Chief Operating Officer and Chief Financial Officer at MarketTools, Inc., an internet-based market research company. Prior to that he served in various positions, including Vice President at BearingPoint, a management and technology consulting firm, President and Chief Operating Officer at Network General, a packet-analysis technology company, President and Chief Executive Officer at DigitalThink, an e-learning enterprise solutions company, and Chief Financial Officer and Chairman of the Audit Committee at Dionex, a chemical systems company, which was subsequently acquired by Thermo Scientific.

Mr. Pope serves on the Board of Arlo Technologies, Inc., a home automation company that makes wireless security cameras.

Mr. Pope started his career in banking and earned a Bachelor of Arts from Stanford University and a Master of Business Administration degree from the Haas School of Business at the University of California, Berkeley.

CORPORATE GOVERNANCE

BOARD LEADERSHIP STRUCTURE

Our business is managed under the direction of the Board, whose members are elected by our stockholders. The basic responsibility of the Board is to lead the company by exercising its business judgment to act in what each director reasonably believes to be the best interests of Shutterfly and our stockholders. Leadership is important to facilitate the Board acting effectively as a working group so that Shutterfly and its financial and operational performance may benefit. The role of the Chairman of the Board includes leading the Board in its annual evaluation of the Chief Executive Officer (in conjunction with the recommendations of the Compensation and Leadership Development Committee of the Board), regularly attending each Committee meeting, providing continuous feedback on the direction, performance and strategy of the company, serving as Chair of regular and executive sessions of the Board, setting the Board's agenda with the Chief Executive Officer, and leading the Board in anticipating and responding to crises. At this time, our Board is led by an independent Chairman, William J. Lansing. Our Chief Executive Officer, Mr. North, is the only member of the Board who was not an independent director. We believe that this leadership structure facilitates the accountability of our Chief Executive Officer to the Board and strengthens the Board's independence from management. In addition, separating these roles allows our Chief Executive Officer to focus his efforts on running our business and managing the day-to-day company operations, while allowing our Chairman to lead the Board in its fundamental role of providing advice to, and independent oversight of, management.

INDEPENDENCE OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

The Nasdaq listing standards require a majority of the members of a listed company's board of directors qualify as "independent," as affirmatively determined by the company's board of directors. Our Board consults with our legal counsel to ensure that the Board's determinations are consistent with all relevant securities and other laws and regulations regarding the definition of "independent," including those set forth in applicable Nasdaq listing standards and the rules and regulations of the Securities and Exchange Commission, as in effect from time to time.

Consistent with these considerations, after review of all relevant transactions or relationships between each director, or any of his or her family members, and Shutterfly, our senior management and PricewaterhouseCoopers LLP, our independent registered public accounting firm, our Board of Directors believes that each of our current directors, other than Mr. North, is independent as required by the Nasdaq listing standards.

As required under applicable Nasdaq listing standards, our independent directors meet in regularly scheduled executive sessions at which only independent directors are present. All of the committees of our Board of Directors are composed entirely of directors determined by the Board to be independent within the meaning of applicable Nasdaq listing standards and Securities and Exchange Commission rules and regulations.

BOARD MEETINGS AND COMMITTEES

During 2018, our Board of Directors and its committees held 28 meetings (including regularly scheduled and special meetings), and each current director attended at least 85% of the aggregate of (i) the total number of meetings our Board held during the period for which he or she served as a director and (ii) the total number of meetings held by all committees of our Board on which he or she served during the periods that he or she served.

It is the policy of our Board of Directors to regularly have separate meetings for independent directors, without management participating.

We do not have a formal policy regarding attendance by members of our Board at annual meetings of stockholders. Nonetheless, we encourage our directors to attend.

Our Board of Directors has an Audit Committee, a Compensation and Leadership Development Committee and a Governance Committee. Each committee operates pursuant to a written charter that is available on our website at *http://ir.shutterfly.com/corporate-governance/committee-composition*. The following table presents committee memberships as of the date of this proxy statement:

NAME	AUDIT	COMPENSATION	GOVERNANCE
Christopher North			
William J. Lansing			Member
Thomas D. Hughes		Member	Member
Eva Manolis			Member
Ann Mather			
Elizabeth S. Rafael	Chairperson		
Elizabeth Sartain		Chairperson	
H. Tayloe Stansbury	Member		
Brian T. Swette	Member		Chairperson
Michael P. Zeisser		Member	
Total meetings in 2018	**9**	**7**	**5**

(Chairperson icon) = Chairperson (Member icon) = Member

* Ann Mather and Christopher North do not currently serve on any committee of the Board.

Audit Committee

The Audit Committee of the Board of Directors (the "Audit Committee") oversees the integrity of our accounting and financial reporting process and the audits of our financial statements. Among other matters, the Audit Committee is directly responsible for the selection, retention and oversight of our independent registered public accounting firm, reviewing our independent registered public accounting firm's continuing independence, approving the fees and other compensation to be paid to our independent registered public accounting firm, pre-approving all audit and non-audit related services provided by our independent registered public accounting firm, reviewing and discussing with management and our independent registered public accounting firm the quarterly and annual financial statements, reviewing and discussing with management and our independent registered public accounting firm our selection, application and disclosure of critical accounting policies, discussing with our independent registered public accounting firm both privately and with management the adequacy of our accounting and financial reporting processes and systems of internal control, reviewing any significant deficiencies and material weaknesses in the design or operation of our internal control over financial reporting, reviewing and discussing with management the Company's program to identify, assess, manage, and monitor significant business risks of the Company, including financial, operational, privacy, cybersecurity and business continuity risks; and annually reviewing and evaluating the composition and performance of the Audit Committee, including the adequacy of the Audit Committee charter.

The Board has determined that each member of the Audit Committee is an independent director under applicable Securities and Exchange Commission and Nasdaq listing standards and meets the requirements for financial literacy under applicable Nasdaq listing standards. The Board has also determined that Ms. Rafael is an "audit

committee financial expert" as that term is defined in applicable Securities and Exchange Commission rules and Nasdaq listing standards.

Compensation and Leadership Development Committee

The Compensation and Leadership Development Committee (the "Committee") has principal responsibility to evaluate, recommend, approve and review executive officer and director compensation arrangements, plans, policies and programs we maintain, and to administer our cash-based and equity-based compensation plans. Among other matters, the Committee is responsible for setting our overall compensation philosophy, reviewing and approving our compensation programs annually, including corporate goals and objectives relevant to the compensation of our executive officers, evaluating the performance of these officers in light of those goals and objectives and setting the compensation of these officers based on such evaluations, administering and interpreting our cash and equity-based compensation plans, annually reviewing and making recommendations to the Board with respect to all cash and equity-based incentive compensation plans and arrangements, and reviewing and evaluating the composition and performance of the Committee on an annual basis, including the adequacy of the Committee charter. Our full Board retains authority to make compensation decisions related to our CEO compensation, subject to review and recommendations of the Committee. The Committee engages outside consultants to provide compensation data and consulting services. In 2018, the Committee directly engaged Frederic W. Cook & Co. Inc., a national compensation consulting firm ("Cook"), as its compensation consultant from January through early April 2018 and Compensia, Inc. ("Compensia") beginning in mid-April through the end of the fiscal year. The Committee has delegated authority to our Chief Executive Officer to grant equity awards annually to individual employees who are not our directors or executive officers.

The agenda for meetings of the Committee is determined by its chair with the assistance of our Chief Executive Officer and Senior Vice President, Chief Human Resources Officer. Committee meetings are regularly attended by the Chief Executive Officer and the Senior Vice President, Chief Human Resources Officer. The Committee's chair reports its actions and recommendations, as applicable, on executive compensation to the Board. The Committee reviews, among other things, the total fees paid to outside consultants in evaluating the objectivity and independence of consultants rendering advice to the Committee.

The Board has determined that each member of the Committee is an independent director under Nasdaq listing standards, a non-employee director within the meaning of Rule 16b-3 of the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act"), and an outside director, as that term is defined under Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code").

Compensation and Leadership Development Committee Interlocks and Insider Participation

During fiscal 2018, the members of our Compensation and Leadership Development Committee were Thomas D. Hughes, Elizabeth Sartain and Michael P. Zeisser. None of the members of our Compensation and Leadership Development Committee in 2018 was at any time during 2018 or at any other time an officer or employee of Shutterfly or any of its subsidiaries, and none had or have any relationships with Shutterfly that are required to be disclosed under Item 404 of Regulation S-K. None of our executive officers has served as a member of our Board, or as a member of the Compensation and Leadership Development Committee or similar committee, of any entity that has one or more executive officers who served on our Board or Compensation and Leadership Development Committee during fiscal 2018.

Governance Committee

The Governance Committee of the Board of Directors (the "Governance Committee") is responsible for making recommendations to the Board regarding director candidates and the structure and composition of our Board and committees of the Board. Among other things, the Governance Committee is responsible for identifying, evaluating and nominating candidates for appointment or election as members of our Board, developing, recommending and evaluating a code of conduct and ethics applicable to all of our employees, officers and directors, and a code applicable to our Chief Executive Officer and senior finance department personnel, recommending that our Board establish special committees as may be necessary or desirable from time to time, recommending policies and procedures for stockholder nomination of directors, and annually reviewing and evaluating its composition and performance, including the adequacy of the Governance Committee charter.

The Board has determined that each member of the Governance Committee is an independent director under Nasdaq listing standards.

BOARD OF DIRECTORS' ROLE IN RISK OVERSIGHT

Together with the Board's standing committees, the Board is responsible for ensuring that material risks are identified and managed appropriately. The Board and its committees regularly review material operational, financial, compensation and compliance risks with senior management. As part of its responsibilities as set forth in its charter, the Audit Committee is responsible for reviewing with management our major financial risk exposures, including reviewing and discussing with management of the Company's program to identify, assess, manage, and monitor potential business risks such as financial, operational, privacy, cybersecurity and business continuity risks, and the steps management has taken to monitor such exposures, including our procedures and any related policies, with respect to risk assessment and risk management. For example, our Chief Financial Officer reports to the Audit Committee on a regular basis with respect to compliance with our risk management policies. The Audit Committee also performs a central oversight role with respect to financial and compliance risks, and reports on its findings at each regularly scheduled meeting of the Board. The Committee oversees compensation risk management by evaluating the design of compensation programs to identify whether any such programs create potential for undesired or unintentional risk-taking behavior. The Governance Committee annually reviews our corporate policies and their implementation. Each committee regularly reports to the Board.

CODE OF CONDUCT AND ETHICS

We have adopted a Code of Conduct and Ethics that applies to all of our officers, directors and employees. We have also adopted an additional written code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer, controller and other employees of the finance department designated by our Chief Financial Officer. These codes are available on our website at http://ir.shutterfly.com/essential-governance-documents. To satisfy the disclosure requirement under Item 5.05 of Form 8-K, any amendments to the codes or grant of any waiver from a provision of the codes to any executive officer or director, will be promptly disclosed on our website at the above-referenced address, as well as by any other means then required by Nasdaq rules or applicable law.

STOCKHOLDER NOMINATIONS TO THE BOARD OF DIRECTORS

The Governance Committee will consider director candidates recommended by stockholders in the same manner in which it evaluates candidates generally. Stockholders who wish to recommend individuals for consideration by the Governance Committee to become nominees for election to the Board at an annual meeting of stockholders must do so in accordance with the procedures set forth in our Bylaws. See "When are stockholder proposals due for next year's annual meeting of stockholders?" above for additional information.

In general, each submission must set forth: (a) as to the stockholder (1) the name and address of the stockholder on whose behalf the submission is made; (2) the class and number of our shares that are directly or indirectly beneficially owned by such stockholder as of the date of the submission; (3) any derivative position in our securities beneficially held by such stockholder as of the date of the submission; (4) any performance-related fees that such stockholder is entitled to, based on any increase or decrease in the value of our shares or derivative position, if any, as of the date of the submission; and (5) a representation whether such stockholder intends to deliver a proxy statement and/or form of proxy to holders of a sufficient number of shares to elect the nominee or nominees submitted; and (b) as to each person whom the stockholder proposes to nominate for election (1) all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, including such person's written consent to being named in such proxy statement as a nominee and to serving as a director if elected; and (2) a statement whether such person, if elected, intends to tender, promptly following such person's election, an irrevocable resignation effective upon such person's failure to receive the required vote for re-election at the next meeting at which such person would face re-election and upon acceptance of such resignation by the Board of Directors, in accordance with our Corporate Governance Guidelines. Stockholder nominations of directors must be addressed to our Corporate Secretary at 2800 Bridge Parkway, Redwood City, CA 94065.

DIRECTOR QUALIFICATIONS

In considering whether to recommend any candidate for inclusion in the Board's slate of recommended director nominees, including candidates recommended by stockholders, the Board considers the Board's diversity. The Board seeks nominees with a broad diversity of experience, professions, skills, geographic representation and backgrounds. Nominees for directors are not discriminated against on the basis of race, religion, national origin, sexual orientation, disability or any other basis proscribed by law. Other characteristics considered by our Governance Committee include

the candidate's character, integrity, judgment, skills, business acumen, experience, commitment, diligence, conflicts of interest and the ability to act in the interests of all stockholders.

Our Board and each of its committees engage in an annual self-evaluation process. As part of that process, directors provide feedback on, among other things, whether the Board has the right set of skills, experience and expertise. This evaluation encompasses a consideration of diversity as described above.

STOCKHOLDER COMMUNICATIONS WITH THE BOARD OF DIRECTORS

Should stockholders wish to communicate with the Board, such correspondence should be sent to the attention of our Corporate Secretary at 2800 Bridge Parkway, Redwood City, California 94065. Our Corporate Secretary will forward the communication to our Board members.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table presents information as to the beneficial ownership of our Common Stock as of March 18, 2019 for:

- each stockholder known by us to be the beneficial owner of more than 5% of our Common Stock;
- each of our directors or director nominees;
- each Named Executive Officer (as defined below in Compensation Discussion and Analysis) as set forth in the summary compensation table below; and
- all current executive officers and directors as a group.

Percentage ownership of our Common Stock in the table is based on 34,170,027 shares of our Common Stock outstanding as of March 18, 2019. In accordance with Securities and Exchange Commission rules and regulations, shares of our Common Stock subject to equity awards that are currently vested or will vest within 60 days of March 18, 2019 (i.e., by May 17, 2019) are deemed to be beneficially owned by the holder of the equity award for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. Unless otherwise indicated, the address of each person named below is c/o Shutterfly, Inc., 2800 Bridge Parkway, Redwood City, California 94065.

	SHARES OF COMMON STOCK BENEFICIALLY OWNED	
NAME OF BENEFICIAL OWNER	NUMBER	PERCENTAGE
5% Stockholders		
Primecap Management Company (1)	4,876,282	14.3%
BlackRock, Inc. (2)	4,828,099	14.1%
The Vanguard Group (3)	3,394,883	9.9%
Christopher North (4)	477,118	1.4%
Michael Pope (5)	59,110	•
Michael Meek (6)	3,081	•
Satish Menon (7)	24,537	•
Maureen Mericle	—	•
Thomas D. Hughes	8,000	•
William J. Lansing	27,124	•
Eva Manolis	6,986	•
Ann Mather	3,928	•
Elizabeth S. Rafael	5,143	•
Elizabeth Sartain	6,627	•

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED	
	NUMBER	PERCENTAGE
H. Tayloe Stansbury	6,025	•
Brian T. Swette	29,200	•
Michael P. Zeisser	21,596	•
All current directors and executive officers as a group (19 persons) (8)	843,269	2.4%

• Represents beneficial ownership of less than 1% of the outstanding shares of common stock.

(1) PRIMECAP Management Company stated in its Schedule 13G/A filed with the SEC on February 8, 2019 that, of the 4,876,282 shares beneficially owned by it, it has (a) sole voting power over 4,219,227 shares, and (b) sole dispositive power over 4,876,282 shares. According to the Schedule 13G/A filing, the address of the principal office of PRIMECAP Management Company is 177 E. Colorado Blvd., 11th Floor, Pasadena, CA 91105.

(2) BlackRock, Inc. stated in its Schedule 13G/A filed with the SEC on January 31, 2019 that, of the 4,828,099 shares beneficially owned by it, it has (a) sole voting power over 4,754,502 shares and (b) sole dispositive power over 4,828,099 shares. According to the Schedule 13G/A filing, the address of the principal office of BlackRock, Inc. is 55 East 52nd Street, New York, NY 10055.

(3) The Vanguard Group, Inc. stated in its Schedule 13G/A filed with the SEC on February 11, 2019 that, of the 3,394,883 shares beneficially owned by it, it has (a) sole voting power over 69,095 shares, (b) shared voting power over 4,518 shares, (c) sole dispositive power over 3,324,070 shares, and (d) shared dispositive power over 70,813 shares. According to the Schedule 13G/A filing, the address of the principal office of The Vanguard Group Inc. is 100 Vanguard Blvd., Malvern, PA 19355.

(4) Mr. North is our President and Chief Executive Officer. Includes 449,791 shares Mr. North has the right to acquire pursuant to outstanding options exercisable within 60 days of March 18, 2019.

(5) Mr. Pope is our Senior Vice President and Chief Financial Officer. Includes 34,308 shares Mr. Pope has the right to acquire pursuant to outstanding options exercisable within 60 days of March 18, 2019.

(6) Mr. Meek is our President and Chief Executive Officer of Lifetouch. Includes 3,081 RSUs eligible for vesting within 60 days of March 18, 2019.

(7) Dr. Menon is our Senior Vice President and Chief Technology Officer. Includes 24,537 shares Dr. Menon has the right to acquire pursuant to outstanding options exercisable within 60 days of March 18, 2019.

(8) Includes 619,693 shares subject to options exercisable within 60 days of March 18, 2019 and 3,081 RSUs eligible for vesting within 60 days of March 18, 2019.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act requires our directors and executive officers, and persons who own more than 10 percent of a registered class of our equity securities, to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our Common Stock and other equity securities. Officers, directors and greater than 10 percent stockholders are required by Securities Exchange Commission regulation to furnish us with copies of all Section 16(a) forms they file.

To our knowledge, based solely on a review of the copies of such reports furnished to us and written representations that no other reports were required, during fiscal 2018, all Section 16(a) filing requirements applicable to our officers, directors and greater than 10 percent beneficial owners were timely met.

PROPOSAL NO. 2 NON-BINDING ADVISORY VOTE TO APPROVE THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS (“SAY-ON-PAY”)

In accordance with Section 14A of the Securities Exchange Act, we are including in this Proxy Statement the opportunity for our stockholders to vote to approve, on a non-binding, advisory basis, the compensation of our Named Executive Officers (as defined below in “Compensation Discussion and Analysis”) as disclosed in this Proxy Statement. The Board has adopted a policy, based on the advisory vote of our stockholders, to provide for an annual say-on-pay advisory vote. Unless the Board modifies its policy on the frequency of future say-on-pay advisory votes, the next say-on-pay advisory vote will be held at the 2020 Annual Meeting of Stockholders.

As described in detail under the heading “Compensation Discussion and Analysis,” the objective of our executive compensation program is to attract, motivate and retain the exceptional leaders we need to drive stockholder value, fulfill our vision and mission, uphold our company values and achieve our corporate goals. We accomplish these goals in a manner consistent with our strategy, competitive practice, sound corporate governance guidelines, and stockholder interests and concerns. We believe the compensation program for our Named Executive Officers was strongly aligned with the long-term interests of our stockholders and the changes made to enhance our programs over the last three years have been effective in driving stockholder value creation.

Accordingly, we are asking you to approve, on a non-binding advisory basis, the compensation of our Named Executive Officers, as described in this Proxy Statement, pursuant to Securities and Exchange Commission compensation disclosure rules, including the “Compensation Discussion and Analysis” below and the related compensation tables and other narrative executive compensation disclosure contained herein.

We are asking our stockholders to vote “FOR” the following resolution at the Annual Meeting:

“RESOLVED, that the stockholders of Shutterfly approve, on a non-binding advisory basis, the compensation of Shutterfly’s Named Executive Officers, as disclosed in the “Compensation Discussion and Analysis,” the compensation tables, the narrative discussion and any related material disclosed in this Proxy Statement.”

This vote is not intended to address any specific item of compensation, but rather the overall compensation of our Named Executive Officers and philosophy, policies and practices described in this Proxy Statement. Further, although the advisory vote is non-binding, the Committee and the Board value the opinions of our stockholders and will review the results of the vote. The Committee and the Board will consider our stockholders’ concerns and take them into account in future determinations concerning our executive compensation program.

THE BOARD RECOMMENDS THAT STOCKHOLDERS VOTE, ON AN ADVISORY BASIS, “FOR” THE APPROVAL OF THE COMPENSATION OF THE COMPANY’S NAMED EXECUTIVE OFFICERS’ DESCRIBED IN THE COMPENSATION DISCUSSION AND ANALYSIS, THE COMPENSATION TABLES, THE NARRATIVE DISCUSSION AND ANY RELATED MATERIAL IN THIS PROXY STATEMENT.

EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

This Compensation Discussion and Analysis ("CD&A") provides a detailed discussion of our compensation philosophy, policies and practices, and the factors and process used in making compensation decisions with respect to our named executive officers for the year ended December 31, 2018 (our "NEOs"). Our NEOs for 2018 were:

- Christopher North, our President and Chief Executive Officer (our "CEO");
- Michael Pope, our Senior Vice President and Chief Financial Officer (our "CFO");
- Michael Meek, our President and Chief Executive Officer of Lifetouch;
- Satish Menon, our Senior Vice President and Chief Technology Officer; and
- Maureen Mericle, our Senior Vice President, Chief Marketing Officer.

Executive Summary

Overview. As the leading retailer and manufacturing platform for personalized products and communications, we operate in numerous dynamic and competitive market segments. The market in which we compete for skilled executive management talent is highly competitive. Our executive compensation program is designed to attract, motivate, and retain the key executives who drive success for our stockholders, customers, and employees. Compensation that reflects performance and aligns with the long-term interests of our stockholders is fundamental to our compensation program design and decisions.

Business Strategy Update. In 2018, we refined our business strategy around three key areas of focus: 1) driving growth in all three of our segments, 2) delivering substantial cost and revenue synergies from our acquisition of Lifetouch in April 2018, and 3) returning capital to stockholders. As the first step of our long-term strategy, for the Shutterfly Consumer segment, we will continue to build on our success in mobile, in category and range expansion, and in the reacceleration of personalized gifts and home décor while making improvement in our prints and our holiday cards offering, supported by marketing and promotional investments. For the Lifetouch segment, we aim to drive account growth in schools and preschools and improve our participation rate through awareness supported by direct-to-consumer communications. In the SBS segment, we will continue to focus on servicing our existing large customers and landing large new customers. We believe effectively executing our strategy positions us to deliver sustainable, profitable growth and create value for our stockholders.

As announced by the Company on February 5, 2019, our Board has also formed a Strategic Review Committee and retained a financial advisor as it continues an ongoing review of strategic alternatives. The Board's Strategic Review Committee is also evaluating the Company's capital structure and capital return policy.

Management Update. In connection with our acquisition of Lifetouch, we appointed Mr. Meek as our President and Chief Executive Officer of the Lifetouch division in April 2018. In addition, Ms. Mericle was appointed as our Senior Vice President, Chief Marketing Officer effective October 2018. As announced on February 5, 2019 and April 4, 2019, Mr. North and Mr. Meek will be stepping down from their roles as our President and Chief Executive Officer and our President and Chief Executive Officer of Lifetouch, respectively. We entered into transition agreements with Mr. North and Mr. Meek pursuant to which they have agreed to remain in their current roles until August 31, 2019 and October 15, 2019, respectively, in order to help facilitate smooth transitions. Mr. James A. Hilt and Mr. Greg Hintz were appointed as President, Shutterfly Consumer and Senior Vice President, Corporate Development, respectively, effective March 2019.

Compensation Program Changes for 2019. Our Committee has continued to take steps to redesign our executive compensation program to support our business strategy and respond to ongoing dialogue with our stockholders. In recent years, we have undertaken a robust stockholder engagement program, speaking with stockholders representing over 50% of our outstanding common stock in the past year. These conversations have included our Chairman, CEO, other members of the Board, CFO and other members of senior management, and covered matters of importance to Shutterfly and our stockholders in a variety of areas, including our executive compensation program. We believe changes made to enhance our programs over the last three years have been effective in driving stockholder value creation. Below is a summary of key feedback and changes we have made for the 2019 compensation year:

WHAT WE HEARD:

BETTER ALIGN INTERESTS OF EXECUTIVES AND STOCKHOLDERS THROUGH USE OF PERFORMANCE-BASED EQUITY AWARDS

WHAT WE DID:

We re-examined our executive compensation structure and redesigned our long-term incentive compensation program for 2019 to de-emphasize the use of stock options in our total equity mix and introduce other performance-based equity vehicles as follows:

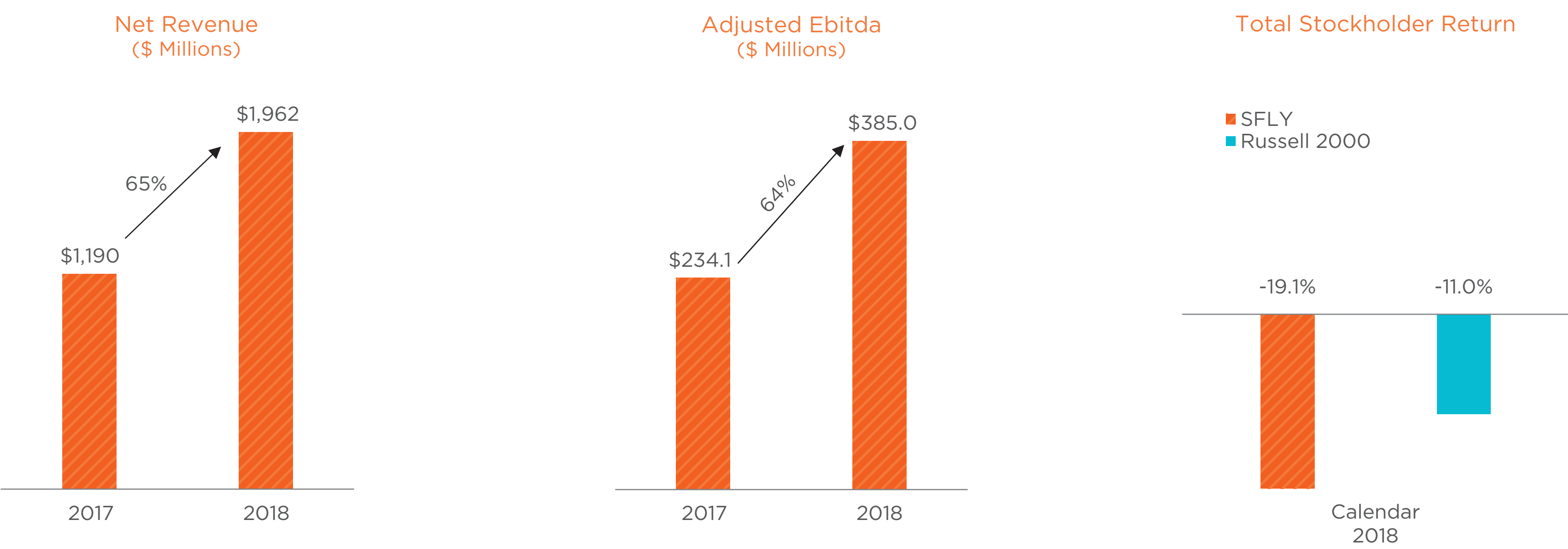
- Introduced Performance Share Unit Awards – We have granted PSU awards to our executive officers, including our NEOs. These awards may be earned based on our Adjusted EBITDA measured over a one-year performance period ending December 31, 2019, with one-third of the earned shares of our common stock vesting upon certification of the achievement of the performance objective and the remaining two-thirds of the shares vesting in equal installments on the second and third anniversaries of the award grant date. The number of shares subject to the awards will be earned from 0% to 200% of the target award based on actual performance over the performance period, with the number of shares to be determined based on a straight-line interpolation basis between threshold and target and target and maximum performance.
- Introduced Market Stock Unit Awards — We have granted performance-based RSU awards to our executive officers. These awards may be earned based on our total stockholder return (TSR) as compared to the Russell 2000 Index over a three-year performance period ending on the 20th trading day following the Company's earnings release for 2021 (in calendar year 2022). The number of shares subject to the awards will be earned from 0% to 200% of the target award based on our TSR compared to the Index as follows:

	TSR PERCENTAGE POINTS COMPARED TO INDEX	TARGET UNITS EARNED
Maximum	Greater than +30 points	200%
Target	Equal	100%
Threshold	-30 points	25%
Below	< -30 points	0%

In addition, award payouts will be capped at the target performance level if our TSR is negative.

- Reduced award value mix of Time-Based Restricted Stock Awards – In connection with the introduction of the performance-based equity award vehicles described above, we have reduced the mix of time-based equity awards granted to our executive officers in the form of restricted stock awards.

2018 Business Results. Under the leadership of our executive team and in large part due to the integration of Lifetouch, we delivered 65% growth in net revenue and 64% growth in Adjusted EBITDA as compared to 2017. Although we had a transformational year in 2018, with the Lifetouch acquisition and almost doubling the size of the Company and ending 2018 with solid results in the Lifetouch and SBS segments, our aggregate results in 2018 came in below our expectations. Our one-year TSR over calendar year 2018 was (19.1)% compared to (11.0)% for the Russell 2000 index. By continuing to execute our long-term strategy, however, we believe we are well-positioned to create stockholder value moving forward.



* See “Non-GAAP Financial Measures” of this Proxy Statement above for a reconciliation of Adjusted EBITDA, a non-GAAP measure, to net income (loss), the closest comparable GAAP measure.

Key 2018 Decisions and Pay Outcomes. Based on our overall operating environment and these results, the Committee took the following key actions with respect to the compensation of our NEOs for and during 2018:

- **Base Salary:** As part of its 2018 annual focal review of executive compensation, the Committee increased the annual base salaries of our incumbent-NEOs (other than our CEO), Michael Pope and Satish Menon, in amounts ranging from 4.0% to 8.4% in order to bring their salaries in line with competitive norms and reflect merit increases. Our CEO’s annual base salary was increased from $700,000 to $750,000 on May 31, 2018, the second anniversary of his employment hire date as provided in his employment offer letter.
- **Short-Term Incentive Compensation:** For 2018, in order to account for our increased revenue following the Lifetouch acquisition, the Committee set our Adjusted EBITDA goal at $410.2 million, increased from $280 million. Consistent with our compensation philosophy, while we exceeded our goal for the first quarter by approximately 43%, we fell short of our overall goal for the year and NEO bonuses for the full year were earned at 35.1% of target (other than Mr. Meek who continued to participate in the existing Lifetouch annual incentive plan (the “Lifetouch Incentive Plan”)).
- **Long-Term Incentive Compensation:** As part of its 2018 annual focal review of executive compensation, the Committee granted long-term incentive compensation to our incumbent-NEOs (other than our CEO), with

approximately 50% in the form of stock options and 50% in the form of RSU awards in amounts ranging in the aggregate from $1,900,000 to $2,700,000. In addition, at that time, Mr. Pope, our CFO, was granted a retention RSU award in the amount of $750,000 in addition to his annual stock option and RSU award.

- **CEO Interim Equity Award:** To further enhance our retention efforts and provide additional incentives for the achievements of our long-term goals, in August 2018, our Board, upon the recommendation of the Committee, granted our CEO a time-based RSU award for 15,897 shares of our common stock that is eligible to vest over four years and a performance-based RSU award for 31,806 shares of our common stock that may be earned based upon achieving a pre-established performance level for Adjusted EBITDA for the Company for the fiscal year ended December 31, 2020. For more information on this award, see "2018 CEO Interim Equity Award" below.
- **Mr. Meek Incentive Equity Award:** In September 2018, the Committee granted Mr. Meek a performance-based RSU award for 39,552 shares of our common stock that may be earned based upon achieving a pre-established performance level for Adjusted EBITDA for the Company and a pre-established performance level for Adjusted EBITDA for Lifetouch for the fiscal year ended December 31, 2020. For more information on this award, see "Lifetouch CEO Incentive Equity Award" below.
- **Compensation Arrangements with Mr. Meek:** In connection with his appointment as President & Chief Executive Officer, Lifetouch, Inc., we extended an employment offer letter effective upon the closing of our acquisition of Lifetouch in April 2018 (the "Meek Offer Letter") to Mr. Meek. Pursuant to the Meek Offer Letter, our initial compensation arrangements with Mr. Meek were as follows:
  - retained his prior annual base salary of $750,000;
  - for the Lifetouch fiscal year ending June 30, 2018, continued participation in the existing Lifetouch Incentive Plan, with a guaranteed payment of at least $375,000 (50% of target) and any additional amounts up to $1,125,000 for maximum achievement under the terms of the Lifetouch Incentive Plan. In addition, for the "stub plan year" between July 1, 2018 and December 31, 2018, the Lifetouch Incentive Plan continued with the same maximum bonus target in place; however, we selected the performance metrics for the stub plan year;
  - a cash retention bonus in the amount of $1,500,000 payable on the second anniversary, April 2, 2020, of the effective date of the Lifetouch acquisition. If he voluntarily resigns his position or his employment is terminated for cause prior to the payment of the retention bonus, the bonus is forfeited. If his employment is terminated for any reason other than cause prior to the payment of the retention bonus, the bonus is prorated based on the number of months he is employed by Lifetouch and Shutterfly following the effective date of the acquisition;
  - the assumption of certain obligations under phantom stock unit awards granted by Lifetouch in September 2017; and
  - a one-time RSU award to acquire 12,324 shares of our common stock. Such award will vest in 25% increments annually on the first, second, third, and fourth anniversaries of the award grant date, subject to his continued employment with us on the applicable vesting dates.

  For a summary of the material terms and conditions of Mr. Meek's phantom stock unit awards, see "Potential Payments upon Termination or Change of Control—Offer Letters and Potential Payments: Lifetouch CEO" below.

  The Meek Offer Letter was approved by our Board. In establishing his initial compensation arrangements, we took into consideration the need to maintain continuity of leadership for Lifetouch, balancing both competitive and internal equity considerations.
- **Compensation Arrangements with Ms. Mericle:** In connection with her appointment as our Senior Vice President and

Chief Marketing Officer, we extended an employment offer letter dated May 14, 2018 (the "Mericle Offer Letter") to Ms. Mericle. Pursuant to the Mericle Offer Letter, our initial compensation arrangements with Ms. Mericle were as follows:

- an initial annual base salary of $365,000;
- a target annual cash bonus opportunity equal to 50% of her annual base salary, paid on a quarterly basis, if earned;
- a one-time RSU award to acquire 31,627 shares of our common stock. Such award will vest in 25% increments annually on the first, second, third, and fourth anniversaries of the award grant date, subject to her continued employment with us on the applicable vesting dates;
- a one-time RSU award to acquire 7,028 shares of our common stock. Such award will vest in full on the second anniversary of the award grant date, subject to her continued employment with us on the applicable vesting date;
- a one-time option to purchase 114,039 shares of our common stock. Such option will vest and become exercisable over four years as follows: 25% of the shares subject to the option will vest and become exercisable on the first anniversary of her hire date and the remaining option shares will vest and become exercisable in equal installments of 1/48th of the total shares subject to the option monthly over the following 36 months, subject to her continued employment with us on the applicable vesting dates; and
- a sign-on and transition bonus in the amount of $1,000,000, payable in two separate lump sum installments; the first, in the amount of $250,000, payable following her 30th day of employment and the second, in the amount of $750,000, payable following January 10, 2019. If she resigns (other than for "good reason") or her employment is terminated for cause prior to the completion of two years of employment, she must refund a pro-rated portion (on a monthly basis) of this bonus amount to us.

The Mericle Offer Letter was approved by the Compensation Committee. In establishing her initial compensation arrangements, we took into consideration the requisite experience and skills that a qualified candidate would need to manage a growing business in a dynamic and ever-changing environment, the competitive market for similar positions at other comparable companies based on a review of compensation survey data, the need to integrate her into our existing executive compensation structure, balancing both competitive and internal equity considerations, and the value of the equity awards that she forfeited and relinquished at her prior employer in accepting a position with us.

Our Corporate Values, Compensation Philosophy, and Practices

Our Values. Our vision and values shape our strategy and corporate goals, which are supported by the design of our compensation program:

- **Our Vision**: Our vision describes our intention to help consumers capture, preserve, and share life's important moments through professional and personal photography, and personalized products. On the enterprise side, we aim to deliver digital printing services that enable efficient and effective customer engagement through personalized communications.
- **Our Values**: We invest in great talent. We act as owners. We are warm, inclusive and collaborative. We debate the most important decisions, then fully commit. We do the right thing for customers. We invest for the long-term while delivering results today. We inspire customers through creativity and beautiful design. We passionately innovate on behalf of our customers. We use data and insight to inform our decisions. We share life's joy.
- **Our Strategies**: We have articulated three primary strategies to support our long-term vision: (1) driving growth in all three of our segments, (2) delivering substantial cost and revenue synergies from our Lifetouch acquisition and (3) returning capital to stockholders.
- **Our Corporate Goals**: Informed by our long-term vision and strategies, each year, we establish overall corporate financial and non-financial goals as an integral part of our strategy to improve corporate performance and increase stockholder value. Our executive

compensation program, policies and practices are designed to create incentives for outstanding execution and to reward our employees, including our NEOs, for their contributions towards achieving such goals.

Our Compensation Philosophy. Our compensation philosophy provides the guiding principles for structuring our executive compensation program. The objective of our program is to attract, motivate and retain the key executives we need in order to drive stockholder value, fulfill our vision and mission, uphold our values and achieve our corporate objectives.

- **Compensation Should Reflect our Pay-for-Performance Culture**. We believe a significant portion of executive pay should be directly linked to performance. Accordingly, a significant portion of our executive compensation is contingent on, and varies based on, growth in stockholder value, achievement of our corporate performance goals and individual contributions to our success.
- **Compensation Should Align with Creation of Stockholder Value**. Additionally, we believe that compensation should incentivize management to achieve short-term goals in a manner that also supports a disciplined path toward our longer-term strategic and financial goals. Performance-based cash bonuses create incentives for achieving results that enhance stockholder value in the short-term, while equity awards serve to align the interests of our executives with our stockholders over the long-term. Our compensation policies and practices are designed to balance short-term and long-term interests, and to prevent the opportunity for inappropriate risk-taking that would have a material adverse effect on us.
- **Compensation Level and Mix Should Reflect Responsibility and Accountability**. Total compensation is higher for executives with greater responsibility, greater ability to influence achievement of our corporate goals and greater accountability for those goals. Further, as responsibility increases, a greater portion of the executive's total compensation is performance-based pay and tied to long-term value creation for our stockholders.

We re-examined our executive compensation structure in 2018 and redesigned our long-term incentive compensation program for 2019 to de-emphasize the use of stock options in our total equity mix and introduced other performance-based equity vehicles. These include performance share unit awards, market stock unit awards and we reduced the award value mix of time-based restricted stock awards.

EXECUTIVE COMPENSATION PROGRAM HIGHLIGHTS

WHAT WE DO

- **Pay for Performance.** Our program is designed to align executive pay with our financial performance and stockholder value creation.
- **Peer Group Analysis.** The Committee reviews total direct compensation (base salary, annual cash incentive and long-term incentive awards) and the mix of the compensation components for our compensation peer group as one of the factors in determining the compensation for our NEOs.
- **CEO Stock Ownership Policy**. Our CEO is required to hold four times his base salary in our stock, which must be achieved within five years of hire.
- **Use of Independent Compensation Consultant.** The Committee is advised by an independent compensation consulting firm that provides no other services to us.
- **Clawback Policy.** The Committee has adopted a clawback policy applicable to all incentive payments provided to our executive officers.

WHAT WE DON'T DO

- **No "Single Trigger" Change-in-Control Payments.** No payments or benefits are payable to our Executives solely on the occurrence of a change-in-control of the company.
- **No Tax Gross-Ups for Excise Taxes.** Our NEOs are not entitled to any tax gross-up payments with respect to excise taxes that may be imposed on certain payments in connection with a change in control.
- **No Hedging, Speculative Trading, or Pledging.** Our trading policies prohibit employees and directors from hedging, speculative trading or pledging of our equity securities.

EXECUTIVE COMPENSATION PROCESS

Role of the Compensation and Leadership Development Committee. The Committee establishes our overall compensation philosophy and reviews and approves our executive compensation program, including the specific compensation of our NEOs (other than our CEO). The Committee relies on its compensation consultant and legal counsel, as well as our CEO, our Chief Human Resources Officer and our executive compensation staff to formulate recommendations with respect to specific compensation actions. During its deliberations, the Committee meets in executive session without our CEO or other management present. The Committee made all relevant decisions for 2018 compensation for our NEOs (other than our CEO). The Committee reviews compensation for our NEOs at least annually.

Generally, the factors considered by the Committee in determining the compensation of our NEOs for 2018 included:

- Shutterfly's performance and our NEOs' individual performance;
- An analysis of market data on compensation at comparable companies;
- The recommendations of our CEO (except with respect to his own compensation);
- The expected future contribution of the individual NEO;
- Our retention objectives;
- Compensation levels of executives with similar responsibilities ("internal pay equity"); and
- Feedback from our stockholders.

The Committee did not weigh these factors in any predetermined manner, nor did it apply any formulas in making its decisions. Instead, the Committee considers this information in light of its knowledge of Shutterfly, knowledge of each executive officer, and using its business judgment in making executive compensation decisions.

Role of Management. Each year, our CEO evaluates the performance of each of our executive officers, including our other NEOs, based on one or more individual performance objectives established at the beginning of the year. Using his qualitative evaluation of each executive officer's performance, accomplishments during the year and areas of strength and areas for development and taking into consideration our corporate and financial performance during the preceding year, our CEO then makes recommendations to the Committee regarding base salary and target bonus adjustments for the current year, as well as equity awards for each of our executive officers (other than himself). The Committee considers these recommendations, as well as the competitive market analysis prepared by its compensation consultant, to determine the individual compensation elements for our NEOs (other than our CEO). While the Committee considers these recommendations and other factors described above, they are among the several factors that the Committee considers in making its decisions with respect to the compensation of our NEOs. Our Board of Directors (other than our CEO) determines the compensation of our CEO, based on recommendations by the Committee. No executive officer participates in the determination of the amounts or elements of their own compensation.

Role of Compensation Consultants. Pursuant to its charter, the Committee has the authority to engage its own legal counsel and other advisors, including compensation consultants, to assist it in carrying out its responsibilities.

The Committee engaged Frederic W. Cook & Co. Inc., a national compensation consulting firm ("Cook"), as its compensation consultant from January through early April 2018 to advise on executive compensation matters, including competitive market pay practices for senior executives, and with the selection and data analysis of the compensation peer group. For 2018, the scope of Cook's engagement included:

- reviewing and developing changes to our compensation peer group;
- conducting an assessment of the compensation for our executive officers, including our NEOs against competitive market data; and
- providing support on other ad hoc matters throughout the engagement period.

The Committee engaged Compensia, a national compensation consulting firm, as its compensation consultant beginning in mid-April 2018. Compensia worked with the Committee and management to review the then-current compensation peer group and our existing executive compensation framework. Compensia also provided the Committee with support regarding the amount and types of compensation that we provide to our executive officers, how these amounts and types of compensation compare to the compensation practices of other companies and advice regarding other compensation-related matters, such as emerging market best practices and regulatory developments.

The terms of Cook's and Compensia's engagements include reporting directly to the Committee chairman. Cook and Compensia also coordinated with our management for data collection and job matching for our executive officers. In 2018, neither Cook nor Compensia provided any other services to us.

The Committee has evaluated its relationships with Cook and, subsequently, Compensia to ensure that it believes that each such firm is independent from management. This review process included a review of the services that each such compensation consultant provided, the quality of those services, and the fees associated with the services provided during 2018. Based on this review, as well as consideration of the factors affecting independence set forth in the listing standards of the NASDAQ Stock Market and the relevant SEC rules, the Committee has determined that no conflict of interest was raised as a result of the work performed by Cook or Compensia, respectively.

Stockholder "Say on Pay" Vote. We hold an annual "Say on Pay" vote for our stockholders to consider the compensation of our NEOs. At our 2018 Annual Meeting of Stockholders, approximately 70% of the votes cast on our "Say on Pay" proposal were voted to approve, on a non-binding advisory basis, the compensation of our named executive officers. Leading up to and following this vote, we have continued our extensive and ongoing stockholder outreach program to discuss the design and operation of our executive compensation program, as well as to gain a better understanding of our stockholders' views and concerns. These discussions included stockholders' desires to further align management's equity awards with stockholder interests. Based on our ongoing stockholder engagement and review of our 2019 compensation policies and practices, we believe the structure of our executive compensation program effectively aligns the interests of our NEOs with our long-term goals. The Committee will continue to consider the outcome of future "Say on Pay" votes and our stockholders' views when making compensation decisions for our NEOs.

Use of Market Data; Compensation Peer Group. To assess the competitiveness of our executive compensation program, the Committee considers the compensation practices of a peer group of high-growth technology companies of reasonably similar size to us. The Committee periodically reviews and approves changes to the compensation peer group based on the recommendation of its compensation consultant. The Committee considers the compensation practices of the peer group companies as one factor in its compensation deliberations but does not "benchmark" compensation at a specific level as compared to our peer group.

The initial compensation peer group for 2018, which was developed with the assistance of Cook in October 2017, was comprised of publicly traded companies operating in the e-commerce and internet software and services sector. This compensation peer group consisted of the following companies:

FIRST HALF OF 2018 PEER GROUP

1-800-Flowers.com, Inc.	Groupon, Inc.	Shutterstock, Inc.	WebMD Health Corp
Box, Inc.	GrubHub Inc.	Stamps.com Inc.	Yelp Inc.
Cimpress N.V.	Match Group, Inc.	TripAdvisor, Inc.	Zillow Group, Inc.
Etsy, Inc.	Pandora Media, Inc.	TrueCar, Inc.	Zynga, Inc.
GoDaddy Inc.	Quotient Technology Inc.	Wayfair Inc.	

The Committee used this compensation peer group in connection with its executive compensation deliberations through June 2018.

In July 2018, at the direction of the Committee following the completion of our acquisition of Lifetouch, Compensia developed a revised compensation peer group to reassess our positioning relative to the competitive market. This updated compensation peer group proposal was based on an evaluation of companies that the

Committee believed were comparable to us, taking into consideration the following factors:

- the peer company's industry—e-commerce, Internet software and services, and broad software;
- the peer company's revenues—approximately $680 million to approximately $6.2 billion (0.33x to 3.0x our estimated revenues of $2.0 billion for the full fiscal year of 2018);
- the peer company's market capitalization—approximately $801 million to approximately $12.5 billion (0.25x to 4.0x our market capitalization of $3.1 billion in June 2018) and
- the peer company's geographic location—focus on the San Francisco Bay Area and other major metropolitan markets.

Based on these criteria, the Committee approved an updated compensation peer group consisting of 20 publicly-traded companies as follows:

SECOND HALF OF 2018 PEER GROUP

1-800-Flowers.com, Inc.	Groupon, Inc.	RH	Wayfair Inc.
Cimpress N.V.	GrubHub Inc.	Shutterstock, Inc.	Williams-Sonoma, Inc.
Etsy, Inc.	IAC/InterActiveCorp	Stitch Fix, Inc.	Yelp Inc.
GoDaddy Inc.	Match Group, Inc.	TripAdvisor, Inc.	Zillow Group, Inc.
GoPro, Inc.	Pandora Media, Inc.	Twitter, Inc.	Zynga, Inc.

The Committee used this compensation peer group in connection with its executive compensation deliberations from July 2018 forward.

To analyze the compensation practices of the companies in our compensation peer group, Compensia gathered data from public filings (primarily proxy statements) of the peer group companies, as well as from a survey of executive compensation provided by Radford Associates, a unit of Aon Hewitt, representing both public and private technology companies that are of similar size with revenues between $1 billion and $3 billion. This market data was then used as a reference point for the Compensation Committee to assess our current compensation levels in the course of its deliberations on compensation forms and amounts.

Compensation Program Elements

Our 2018 executive compensation program was composed of three primary elements:

- Base salary;
- Short-term incentive compensation in the form of quarterly performance-based cash bonuses; and
- Long-term incentive compensation in the form of equity awards.

Other elements include employment agreements, severance and change-in-control arrangements, retirement, health and welfare benefits, and limited perquisites with a sound business purpose.

Base Salary. We pay base salaries to provide our executive officers, including our NEOs, with a competitive level of fixed, annual compensation. The Committee sets the annual base salaries of our executive officers at levels it believes will enable us to hire and retain individuals in a competitive environment and to reward individual performance and contribution to our overall corporate goals. In determining base salaries, the Committee considers each executive officer's qualifications and experience, position and scope of responsibilities, competitive market data, internal pay equity, and job performance. Salary reviews are conducted annually; however, individual salaries are not necessarily adjusted each year.

In February 2018, the Committee reviewed the base salaries of our incumbent-NEOs (other than our CEO), taking into consideration a competitive market analysis prepared by its compensation consultant and the recommendations of our CEO, as well as the other factors described above. Following this review, the Compensation Committee approved base salary increases for our incumbent-NEOs (other than our CEO) effective April 2018, to bring their base salaries to levels that were comparable to those of similarly-situated executives at the companies in our compensation peer group. Mr. North's annual base salary was increased from $700,000 to $750,000 on May 31, 2018, the second anniversary of his employment hire date, as provided in his employment offer letter. The base salaries of our incumbent NEOs for 2018 were as follows:

NEO	2017 BASE SALARY	2018 BASE SALARY (1)	PERCENTAGE ADJUSTMENT
Mr. North	$700,000	$750,000	7.1%
Mr. Pope	$415,000	$450,000	8.4%
Dr. Menon	$375,000	$390,000	4.0%

(1) Mr. North's annual base salary was increased from $700,000 to $750,000 on May 31, 2018, the second anniversary of his employment hire date, as provided in his employment offer letter.

In connection with their appointment as our President & Chief Executive Officer, Lifetouch, Inc. and our Senior Vice President, Chief Marketing Officer, respectively, in 2018, the Committee retained Mr. Meek's annual base salary with Lifetouch at $750,000 and set the annual base salary for Ms. Mericle at $365,000, effective as of their employment start dates.

Short-term Performance-based Incentive Program. We use cash bonuses to reward the performance of our executive officers, including our NEOs, for their contributions to our overall corporate financial and operational performance for the current fiscal year.

For 2018, we maintained the simplified design for our executive cash bonus plan that we had introduced in 2017 to continue to encourage our executive officers to have a singular focus on our Adjusted EBITDA performance, as we continued our initiatives to consolidate our consumer brands and position Shutterfly for profitable growth (the "2018 Bonus Plan"). In 2019, we transitioned to evaluating and rewarding our executive officers based on annual performance periods as the Committee determined this was the most effective method to set rigorous goals in light of the significant seasonality of our business (the "2019 Bonus Plan"). We believe the enhancements we have made in 2019 further reflect stockholder interests.

	2017 AND 2018 BONUS PLAN	2019 BONUS PLAN
Goal Setting	Annual	Annual
Performance Period	Quarterly	Annual
Financial Metrics	Adjusted EBITDA	Adjusted EBITDA
Individual Performance	No	Adjustment for individual performance
Divisional Performance	No	Adjustment for divisional performance

Individual Target Cash Bonus Opportunities

In 2018, the annual target cash bonus opportunities were set at 100% of base salary for our CEO and Michael Meek and 50% of base salary for our other executive officers, including our incumbent-NEOs (other than our CEO). In addition, the annual target cash bonus opportunities for all participants in the 2018 Bonus Plan (in which Mr. Meek did not participate) were weighted by fiscal quarter at 20% of the target annual cash bonus opportunity for each of the

first three fiscal quarters of 2018, and 40% for the fourth fiscal quarter to reflect the proportional weight of our quarterly financial target levels relative to our annual revenue and profits.

Individual awards under the 2018 Bonus Plan could range from 0% to 200% of the target award in total, but payouts during each of the first three quarters were capped at 100% of target with above-target amounts held-back and rolled over to the subsequent quarter.

In connection with their appointment as our President and Chief Executive Officer of Lifetouch and our Senior Vice President, Chief Marketing Officer, respectively, in 2018, the Committee set the annual target cash bonus opportunities of Mr. Meek and Ms. Mericle at 100% and 50% of their base salary, respectively, effective as of their employment start date. For 2018, the annual target cash bonus opportunity for Ms. Mericle was pro-rated as of her employment start date.

Financial Metrics

For 2018, the Committee selected Adjusted EBITDA as the performance metric for the 2018 Bonus Plan. For purposes of the 2018 Bonus Plan, "Adjusted EBITDA" was to be calculated by taking our earnings before interest, taxes, depreciation, amortization, stock-based compensation expense, capital lease termination, restructuring, purchase accounting adjustments and acquisition costs. The 2018 performance goals for Adjusted EBITDA were developed based on recent historical financial performance, planned strategic initiatives, and the then-existing economic environment. As described hereafter, those goals were adjusted mid-year to recognize our acquisition of Lifetouch.

The 2018 Bonus Plan was structured so that if we missed our Adjusted EBITDA goal, then bonuses would be reduced potentially all the way to a zero payout. The Committee believed that this design would help ensure that any bonus payments made under the 2018 Bonus Plan would be made only if warranted by our actual financial and operational performance, consistent with our pay-for-performance philosophy.

The Adjusted EBITDA target performance levels set by the Committee under the 2018 Bonus Plans were as follows:

PERIOD	PERIOD WEIGHTING	2017 ACTUAL ADJUSTED EBITDA ($ MIL.)	2018 ADJUSTED EBITDA GOAL ($ MIL.)	2018 ACTUAL ADJUSTED EBITDA ($ MIL.) (1)	2018 BONUS FUNDING
First Quarter	20%	($ 1.9)	$ 5.1	$ 7.1	100%(1)
Second Quarter(2)	20%	17.4	71.3	84.4	72.5%
Third Quarter	20%	3.0	(25.6)	(26.3)	0%
Fourth Quarter	40%	215.6	359.4	319.8	0%
Total		**$ 234.1**	**$410.2**	**$385.0**	**35.1%**

(1) First quarter payout was capped at 100% with amounts payable for overachievement paid as part of the fourth quarter bonus, once full-year results were determined.

(2) In April 2018, in order to account for our increased revenue following the Lifetouch acquisition, the Committee revised our total Adjusted EBITDA goal to $410.2 million resulting in a $130 million increase for our full year target. Our original Adjusted EBITDA goals were $23.9 million, $1.4 million, and $249.7 million for the second, third and fourth quarters of 2018, respectively.

Bonus Decisions

At each of its quarterly meetings where it reviewed our financial results for purposes of the 2018 Bonus Plan, the Committee considered the potential bonus payments for each of our executive officers, including our NEOs. For the first quarter of 2018, we exceeded our performance goal for Adjusted EBITDA, resulting in a bonus accrual of 143% since our actual performance exceeded plan. However, as provided by the terms of the 2018 Bonus Plan, payouts for the first quarter were capped at 100% of the target cash bonus opportunity. While we also exceeded the performance goal for Adjusted EBITDA in the second quarter of 2018, as a result of the Committee's decision to limit payouts to the level reached in the corporate bonus plan which did not reflect increased Lifetouch revenue, payouts were capped at 72.5% of the quarter's target cash bonus, subject to a "true-up" opportunity in the fourth quarter. For the third and fourth quarters of 2018, we did not achieve our threshold performance goal for Adjusted EBITDA, resulting in no payout under the plan for either of these quarters.

The following table presents the quarterly bonus payments that were made to the NEOs (other than Mr. Meek) under the 2018 Bonus Plan.

NEO	Q1	Q2	Q3	Q4	TOTAL	% SAL.	% TARGET
Mr. North	$140,000	$108,750	—	—	$248,750	33.2%	35.1%
Mr. Pope	$ 45,000	$ 32,625	—	—	$ 77,625	17.3%	35.1%
Dr. Menon	$ 39,000	$ 28,275	—	—	$ 67,275	17.3%	35.1%
Ms. Mericle	N/A	N/A	N/A	—	—	—	—

Mr. Meek's Annual Incentive Awards. As the Chief Executive Officer of Lifetouch, Mr. Meek was eligible to participate in the Lifetouch Annual Incentive Plan that operated concurrent with Lifetouch's annual fiscal year, which ran from July 1, 2017 to June 30, 2018. The financial metrics for this plan were revenue and operating income. As the senior executive of Lifetouch, Mr. Meek's target annual cash incentive opportunity, which was $750,000, was based on Lifetouch's performance for revenue (weighted 40%) and operating income (weighted 60%), with a guaranteed payment of at least $375,000 and any additional amounts up to $1,125,000 for maximum achievement. For the Liftetouch fiscal year ended June 30, 2018 ("Lifetouch fiscal 2018"), Lifetouch's revenue and operating income of $908.8 million and $95.9 million, respectively, exceeded its target performance level of $900.0 million and $84.4 million, respectively resulting in a bonus payout percentage of 122.4%. This resulted in a bonus payout to Mr. Meek for Lifetouch fiscal 2018 of $917,740.

In connection with integrating Lifetouch into Shutterfly's fiscal year, the Committee approved a six-month bonus plan for the executives of Lifetouch, including Mr. Meek, based on the company's revenue and Adjusted EBITDA. As the senior executive of Lifetouch, Mr. Meek's target annual cash incentive opportunity, which was $375,000, was based entirely on the company's performance for revenue (weighted 40%) and Adjusted EBITDA (weighted 60%). For this six-month period ended December 31, 2018, Lifetouch's revenue and Adjusted EBITDA of $536.8 million and $90.8 million exceeded their threshold performance levels of $533.3 million and $87.6 million, but did not achieve the target performance levels of $541.4 million and $91.3 million, respectively, resulting in a bonus payout percentage of 41%. This resulted in a bonus payout to Mr. Meek for the six-month bonus plan of $153,949.

Long-term Incentive Compensation. We use long-term incentive compensation in the form of equity awards to motivate our executive officers, including our NEOs, by providing them with the opportunity to build an equity interest in Shutterfly and to share in the potential appreciation of the value of our common stock. Consistent with our historic review of our long-term incentive program and our subsequent compensation decisions, we used options to purchase shares of our common stock and restricted stock unit ("RSU") awards that may vest and be settled for shares of our common stock as the vehicles for delivering long-term incentive compensation opportunities to our executive officers in the early part of 2018.

Because options to purchase shares of our common stock provide for an economic benefit only in the event that our stock price increases over the exercise price of the option (which exercise price is equal to the fair market value of our common stock as of the date of grant), the Committee believes that these equity awards effectively align the interests of our executive officers with those of our stockholders and provide our executive officers with a significant incentive to manage our business from the perspective of an owner with an equity stake in the business. The choice to grant stock options to our executive officers also reflects the Committee's belief that our executive officers are in a direct position to advance the market price of our common stock through successful execution of our business strategy. In addition, because they are subject to a multi-year vesting requirement, stock options serve our retention objectives since our executive officers must remain continuously employed by us through the applicable vesting dates to have an opportunity to exercise their stock options.

With respect to RSUs, the Committee believes that because RSUs representing the right to receive shares of our common stock upon settlement have value even in the absence of

stock price appreciation, we are able to incent and retain our executive officers using fewer shares of our common stock. Since their value increases with any increase in the value of the underlying shares, RSUs serve as an incentive which aligns with the long-term interests of our executive officers and stockholders. Unlike stock options, however, RSUs have real economic value when they vest even if the market price of our common stock declines or stays flat, thus delivering more predictable value to our executive officers. In addition, because they are subject to a multi-year vesting requirement, RSUs serve our retention objectives since our executive officers must remain continuously employed by us through the applicable vesting dates to fully earn these awards. Finally, because of their "full value" nature, RSUs deliver the desired grant date fair value using a lesser number of shares than an equivalent stock option, thereby enabling us to reduce the dilutive impact of our long-term incentive award mix and to use our equity compensation resources more efficiently and better manage the overall number of shares granted to our executive officers.

Beginning in mid-2018, we introduced performance-based equity awards into our long-term incentive program in the form of performance share unit ("PSU") awards for our CEO and Mr. Meek. The 2018 PSU awards granted to our CEO and Mr. Meek enable them to earn shares of our common stock based on our Adjusted EBITDA performance over a multi-year period.

In 2019, we granted PSUs to our remaining executive officers, including our NEOs, and introduced market stock unit ("MSU") awards. The PSU awards enable our executive officers to earn shares of our common stock based on our Adjusted EBITDA performance over a one-year performance period. We believe that PSU awards serve as a source of motivation to our executive officers to drive financial performance. In addition, PSU awards provide a direct link between compensation and stockholder return, thereby motivating our executive officers to focus on and strive to achieve both our annual and long-term financial and strategic objectives. The MSU awards enable our executive officers to earn shares of our common stock based on our performance relative to the Russell 2000 Index over performance periods of up to three years. We believe that these awards serve as a source of motivation to our executive officers even in a down-market environment by providing upside potential if we outperform the Russell 2000 Index over the relevant performance period. In addition, MSU awards provide a direct link between compensation and stockholder return, thereby motivating our executive officers to focus on and strive to achieve both our annual and long-term financial and strategic objectives.

In determining the amount of the long-term incentive compensation awards to grant to our executive officers, including our NEOs, the Committee considers a number of reference points, including the executive officer's performance, such executive's then-current total direct compensation (i.e., the sum of base salary, target cash bonuses and the fair value of equity awards), the compensation paid to such executive's peers within Shutterfly, the compensation paid to executives in comparable positions at other companies within our peer group, the remaining vesting period and expected value (and thus, retention value) of such executive's outstanding equity awards, and such executive's ability to affect profitability and stockholder value. In making equity award decisions, the Committee's primary objectives are to reward long-term performance, align the long-term incentive compensation of our executive officers with stockholder interests, and maximize executive retention. The Committee takes a holistic approach in its deliberations and does not place any specific weight on these factors, nor does it apply a formula to determine the amounts awarded.

2018 Equity Awards

In February 2018, after taking into consideration a competitive market analysis prepared by its compensation consultant and the recommendations of our CEO, as well as the other factors described above, the Committee approved annual equity awards for our executive officers, including our incumbent NEOs (other than our CEO). These equity awards consisted of options to purchase shares of our common stock and RSU awards that may vest and be settled for shares of our common stock. The award mix was set at approximately 50% stock options and 50% RSUs by value, to balance increases for growth with ongoing retention. In addition, in February 2018 and April 2018, the Committee approved the grant of RSU awards to Mr. Pope and Mr. Meek, respectively, for retention purposes. In August and September 2018, the Board approved the grant of performance-based RSU awards to Mr. North and Mr. Meek, respectively, to motivate them to drive financial performance.

The equity awards granted to our NEOs in 2018 were as follows:

NEO	ANNUAL / NEW HIRE SHARE TOTALS			RETENTION RSU AWARDS (NO.)	AGGREGATE GRANT DATE FAIR VALUE OF EQUITY AWARDS ($)
	STOCK OPTION AWARDS (NO.)	RSU AWARDS (NO.)	PBRSU AWARDS (TARGET NO.)		
Mr. North	—	15,897	31,806	—	3,509,510
Mr. Pope	57,276	21,558	—	11,977	3,923,044
Mr. Meek	—	—	39,552	12,324	4,062,744
Dr. Menon	40,305	15,170	—	—	2,113,918
Ms. Mericle	114,039	38,655	—	—	4,787,462

The options to purchase shares of our common stock were granted with exercise prices equal to the closing market price of our common stock on the date of grant and with a seven-year term. Such stock options are subject to a four-year vesting schedule, with 25% of the shares subject to the options vesting on the first anniversary of the date of grant and in equal monthly installments thereafter, contingent on the NEO's continued employment by us through each applicable vesting date.

The annual RSU awards, retention RSU awards to Mr. Meek, the interim RSU award granted to Mr. North and the RSU award of 31,627 shares of our common stock granted to Ms. Mericle are also subject to a four-year vesting schedule, with the shares subject to the awards vesting in four equal annual installments on each anniversary of the grant date, contingent on the NEO's continued employment by us through each applicable vesting date.

The retention RSU award granted to Mr. Pope and the RSU award of 7,028 shares of our common stock granted to Ms. Mericle vest in full on the second anniversary of the date of grant, contingent on their continued employment by us on such date.

For information on the vesting schedule and contingencies of the performance-based RSU awards, see "2018 CEO Interim Equity Award" and "Lifetouch CEO Incentive Equity Award" below.

2018 CEO Interim Equity Award

In August 2018, the Committee recommended, and our Board (other than our CEO) approved, the grant to our CEO of:

- a time-based RSU award for 15,897 shares of our common stock, with such award subject to a four-year vesting schedule, with the shares subject to the awards vesting in four equal annual installments on each anniversary of the grant date, contingent on his continued employment by us through each applicable vesting date; and
- a performance-based RSU award for 31,806 shares of our common stock to be earned based on the achievement of adjusted EBITDA as set forth below during the fiscal year ended December 31, 2020 (with the potential to convert to a larger or smaller number of shares depending on our actual performance versus the target performance level) and contingent on his continued employment by us as of the third anniversary of the date of grant of the award.

For purposes of determining the number of shares of our common stock earned pursuant to the performance-based RSU award, the following performance multiplier applies:

LEVEL OF ACHIEVEMENT	ADJUSTED EBITDA (1)	PERFORMANCE MULTIPLIER (2)
Maximum	≥ $525 million	200%
Target	$475 million	100%
Threshold	$425 million	50%
Below Threshold	< $425 million	0%

(1) For purposes of the performance-based RSU award, "Adjusted EBITDA" means earnings before interest, taxes, depreciation, amortization, stock-based compensation, capital lease termination, restructuring and acquisition costs, as may be adjusted by the Committee in its discretion.

(2) The performance multiplier for any level of achievement falling between threshold, target, and maximum performance levels will be measured based on linear interpolation.:

On February 5, 2019, we announced that our CEO will be stepping down at the end of August 2019, and that the Board has engaged an executive search firm to identify candidates to succeed him. On February 4, 2019, the Company entered into a Transition Agreement (the "Transition Agreement") for transition services through August 31, 2019 (the "Transition Period") with our CEO, pursuant to which he will receive his base salary as currently in effect and continue to vest in his outstanding stock options and time-based restricted stock unit awards ("RSUs") while he provides services during the Transition Period. Upon Mr. North's termination at the end of the Transition Period, Mr. North shall be entitled to receive a lump sum bonus of $562,500. Mr. North will not be eligible to participate in the Company's 2019 Bonus Plan and Mr. North's 2018 performance-based RSUs were cancelled pursuant to the Transition Agreement.

Lifetouch CEO Incentive Equity Award

In September 2018, the Committee approved the grant to Mr. Meek, the President and Chief Executive Officer of Lifetouch, of a performance-based RSU award for 39,552 shares of our common stock to be earned based on:

- our achievement of Adjusted EBITDA of at least $450 million during the fiscal year ended December 31, 2020 (the "Performance Period");
- Lifetouch contributing at least $235 million to our combined Adjusted EBITDA during the Performance Period (with the potential to convert to a larger number of shares or none depending on our actual performance versus the target performance level); and
- his continued employment by us as of the third anniversary of the date of grant of the award.

For purposes of determining the number of shares of our common stock earned pursuant to this performance-based RSU award, the following performance multiplier applies:

LEVEL OF ACHIEVEMENT	LIFETOUCH CONTRIBUTION PROFIT (1)	OVERACHIEVEMENT OF PLAN	PERFORMANCE MULTIPLIER (2) (PERCENTAGE OF TARGET AND AMOUNT)
Maximum	≥ $265 million	$40 million	200% ($6 million)
Target	$245 million	$20 million	100% ($3 million)
Threshold	$235 million	$10 million	50% ($1.5 million)
Plan	$225 million	—	0% (no payment between plan and threshold)

(1) For purposes of the performance-based RSU award, "Adjusted EBITDA" means earnings before interest, taxes, depreciation, amortization, stock-based compensation, capital lease termination, restructuring and acquisition costs, as may be adjusted by the Committee in its discretion.

(2) The performance multiplier for any level of achievement falling between threshold, target, and maximum performance levels will be measured based on linear interpolation.

Other Compensation Elements

Health and Welfare Benefits. Our NEOs participate in our retirement, health, and welfare benefits on the same basis as all our full-time employees. We maintain a tax-qualified Section 401(k) retirement plan for all employees who satisfy certain eligibility requirements, including requirements relating to age and length of service. We provide Company matching contributions up to 3% of base pay to our Section 401(k) retirement plan. In addition, we also offer medical, dental and vision benefits, medical and dependent care flexible spending accounts, short-term and long-term disability insurance, accidental death and dismemberment insurance, and basic life insurance coverage to our NEOs on the same terms and conditions as our employees generally.

Perquisites and Other Personal Benefits. Generally, we do not provide perquisites to our executive officers, including the NEOs, except in situations where we believe it is appropriate to assist an individual in the performance of his or her duties, to make our executive officers more efficient and effective, and for recruitment and retention purposes. During 2018, none of our NEOs received perquisites or other personal benefits that were, in the aggregate, $10,000 or more for each individual, except that Mr. Meek was provided the benefit of driving a company-owned car and mileage driven for a benefit of $28,968 and a gross-up for federal and state income taxes of $24,243, a country club membership reimbursement for a benefit of $10,487 and an executive physical from the Mayo Clinic for a benefit of $9,647.

Sign-On Transition Bonuses. In connection with their hires and as an inducement to join the Company, Ms. Mericle and Mr. Meek were each provided sign-on bonuses. Ms. Mericle's sign-on bonus of $1.0 million was to be paid in two separate lump-sum installments; 25% in the pay period following her 30th day of employment, October 30, 2018, then 75% in the pay period following January 10, 2019. The bonus is subject to pro-rata repayment upon resignation or termination of employment for cause during the first two years of employment. Mr. Meek's sign-on bonus of $1.5 million is to be paid in a single lump-sum on the second anniversary, April 2, 2020, of the Lifetouch acquisition provided he continues to be employed by the Company at such time. The bonus is subject to forfeiture upon resignation or termination of employment for cause prior to such date.

Termination and Change in Control Arrangements

To enable us to attract talented executive officers, as well as ensure ongoing retention when considering potential corporate transactions that may create uncertainty as to future employment, we offer certain post-employment payments and benefits to our NEOs. These payments and benefits are generally standard for our NEOs (other than Mr. Meek and the CEO) and are included in each executive's Retention Agreement (each as described under the heading "Executive Compensation Tables—Potential Payments upon Termination or Change in Control"). Post-termination benefits for Mr. Meek are described in the Meek Offer Letter. Potential payments and benefits payble to our CEO upon a termination of employment prior to the last day of his transition period on August 31, 2019 are set forth in his Transition Agreement and described under the heading "Executive Compensation Tables—Potential Payments upon Termination or Change in Control". We believe these arrangements reinforce the commitment of our executive officers to pursue increased stockholder value amid personal uncertainties that may arise during times of transition, including in a transaction setting, and serve as an important retentive tool to promote stability in our management team through the completion of any such transaction.

All payments and benefits in the event of a change in control of Shutterfly are payable only if there is a subsequent separation of employment by an executive officer (a so-called "double-trigger" arrangement). In the case of the acceleration of vesting of outstanding equity awards, we use this double-trigger arrangement to protect against the loss of retention value following a change in control of the Company and to avoid windfalls, both of which could occur if vesting of either equity or cash-based awards accelerated automatically as a result of the transaction. We have no "single-trigger" severance or equity vesting provisions that are contingent solely on occurrence of a change in control of Shutterfly.

In addition, none of our executives are entitled to Section 280G excise tax "gross-up" payments. For a summary of the material terms and conditions of the severance and change in control arrangements in effect as of December 31, 2018, see the information under the heading "Executive Compensation Tables—Potential Payments upon Termination or Change in Control".

Other Policies

Stock Ownership Policy. Our stock ownership policy is designed to encourage our CEO and the non-employee members of our Board to achieve and maintain a significant equity stake in Shutterfly and more closely align their interests with those of our stockholders. The current stock ownership levels are as follows:

INDIVIDUAL SUBJECT TO STOCK OWNERSHIP POLICY	MINIMUM REQUIRED LEVEL OF STOCK OWNERSHIP
Chief Executive Officer	Four times current annual base salary
Non-Employee Members of our Board of Directors	$200,000

Owned shares and vested RSUs (including RSUs held by non-employee members of our Board pursuant to our deferred compensation plan) are included for purposes of calculating ownership. The minimum level of ownership is expected to be achieved within five years of hire for our CEO and within two years of appointment for a non-employee director. During these grace periods, we have established policies to ensure that covered individuals are on track to meet the minimum level of ownership within the required time periods. As of December 31, 2018, the Committee was satisfied that all covered individuals were on track to do so.

Compensation Recovery Policy. We maintain an Executive Officer Recoupment Policy that provides for the recovery of annual incentive compensation from any of our executive officers, including our NEOs, in the event of a substantial financial restatement resulting from the fraud or intentional misconduct of any executive officer.

This policy enables the Committee to seek recoupment of the incremental portion of bonuses paid to our executive officers in excess of the awards that would have been paid based on the restated financial statements. We intend to update this policy, to the extent necessary, once the SEC adopts final rules implementing Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Anti-Hedging Policy. Under our stock ownership policy, our CEO and the non-employee members of our Board are prohibited from speculating in our equity securities, including the use of short sales, "sales against the box," or any equivalent transaction involving our equity securities. In addition, they may not engage in any other hedging transactions, such as "cashless" collars, forward sales, equity swaps and other similar or related arrangements, with respect to our securities that they hold. Under our insider trading policy, no employee, officer or member of our Board may acquire, sell or trade in any interest or position relating to the future price of our equity securities.

Anti-Pledging Policy. Under our insider trading policy, our executive officers and the non-employee members of our Board are prohibited from pledging, hypothecating, using as collateral for any loan or other obligation, or granting a security interest in any Company securities without the prior authorization of the policy's compliance officer.

Accounting and Tax Considerations

The accounting impact and tax deductibility of our compensation plans and arrangements are each factors that are considered in determining the size and structure of our executive compensation program. Section 162(m) of the Code generally disallows the deductibility by any publicly held corporation of individual compensation expense in excess of $1 million paid to certain executive officers ("covered executives") within a taxable year. Recent changes to Section 162(m) in connection with the passage of the Tax Cuts and Jobs Act repealed exceptions to the deductibility limit that were previously available for "qualified performance-based compensation," including stock option grants, effective for taxable years after December 31, 2017. As a result, any compensation paid to the covered executives in excess of $1 million will be non-deductible unless it qualifies for transition relief afforded to compensation payable pursuant to certain binding arrangements in effect on November 2, 2017. Because of uncertainties in the interpretation and implementation of the changes to Section 162(m), including the scope of the transition relief, we can offer no assurance of such deductibility. All other cash and equity compensation in excess of $1 million paid to the covered executives will not be deductible.

The Committee seeks to balance the cost and benefit of tax deductibility with our executive compensation goals designed to promote long-term stockholder interests and continues to reserve discretion to approve new compensation or modify existing compensation arrangements that result in a loss of deductibility when it believes that such payments are appropriate to attract and retain executive talent. Accordingly, we expect that a portion of our future cash compensation and equity awards to our executive officers will not be deductible under Section 162(m).

The Committee takes accounting considerations into account in designing compensation plans and arrangements for our executive officers and other employees. Chief among these is Financial Accounting Standards Board Accounting Standards Codification Topic 718 (“ASC Topic 718”), the standard which governs the accounting treatment of certain stock-based compensation. Among other things, ASC Topic 718 requires us to record a compensation expense in our income statement for all equity awards granted to our executive officers and other employees. This compensation expense is based on the grant date “fair value” of the equity award and, in most cases, will be recognized ratably over the award’s requisite service period (which, generally, will correspond to the award’s vesting schedule). This compensation expense is also reported in the compensation tables below, even though recipients may never realize any value from their equity awards.

Compensation Risk Considerations

The Committee regularly considers potential risks when reviewing and approving our compensation programs, including our executive compensation program, and does not believe that our compensation programs encourage excessive or inappropriate risk taking. As described in further detail in this “Compensation Discussion and Analysis,” we structure our programs with specific features to address and mitigate potential risks while rewarding our employees for achieving our financial and strategic objectives through prudent business judgment and appropriate risk taking. In 2018, the Committee and management considered whether our compensation programs, including our executive compensation program, created incentives for our employees to take excessive or unreasonable risks that could materially harm Shutterfly. The Committee believes that our compensation programs are typical for companies in our industry and that the risks arising from our compensation policies and practices are not reasonably likely to have a material adverse effect on Shutterfly.

REPORT OF THE COMPENSATION AND LEADERSHIP DEVELOPMENT COMMITTEE OF THE BOARD OF DIRECTORS

The material in this report is not "soliciting material," is not deemed "filed" with the Securities and Exchange Commission, and is not to be incorporated by reference into any filing of Shutterfly under the Securities Act of 1933, as amended, or the Securities Exchange Act.

The Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Proxy Statement incorporated by reference in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

Compensation and Leadership Development Committee

Elizabeth Sartain, Chair

Thomas D. Hughes

Michael P. Zeisser

EXECUTIVE COMPENSATION TABLES

SUMMARY COMPENSATION TABLE

The following table presents compensation information for each NEO for the year ended December 31, 2018, and, to the extent required by the Securities and Exchange Commission compensation disclosure rules, the years ended December 31, 2017 and 2016. The table does not include columns for "Change in Pension Value and Nonqualified Deferred Compensation Earnings" because there were no amounts to report for the years presented.

NAME AND PRINCIPAL POSITION	YEAR	SALARY ($)(1)	BONUS ($)(2)	STOCK AWARDS ($)(3)	OPTION AWARDS ($)(4)	NON EQUITY INCENTIVE PLAN COMPENSATION ($)(5)	ALL OTHER COMPENSATION ($)(6)	TOTAL ($)
Christopher North (7)	2018	723,077	—	3,509,510	—	248,750	—	4,481,337
President and Chief	2017	700,000	—	—	—	856,800	—	1,556,800
Executive Officer	2016	411,202	1,972,450	7,245,000	11,475,000	—	354,333	21,457,985
Michael Pope	2018	441,923	—	2,573,141	1,349,904	77,625	—	4,442,593
Senior Vice President,	2017	415,000	—	1,051,625	943,283	203,184	—	2,613,092
Chief Financial Officer	2016	415,000	—	—	—	105,450	—	520,450
Michael Meek (8)	2018	548,077	375,000	4,062,744	—	542,582	73,345	5,601,748
President and Chief Executive	2017	—	—	—	—	—	—	—
Officer of Lifetouch	2016	—	—	—	—	—	—	—
Satish Menon	2018	386,538	—	1,163,994	949,924	67,275	—	2,567,731
Senior Vice President,	2017	375,000	—	1,297,750	762,652	183,600	—	2,619,002
Chief Technical Officer	2016	374,180	—	1,899,993	—	85,350	—	2,359,523
Maureen Mericle	2018	77,212	250,000	2,537,701	2,249,761	—	—	5,114,674
Senior Vice President,	2017	—	—	—	—	—	—	—
Chief Marketing Officer	2016	—	—	—	—	—	—	—

(1) The amounts in this column reflects a pro-rated base salary for Mr. North in 2016 (reflecting his appointment in March 2016) and his annual base salary in 2017 and 2018, including a raise in Mr. North's base salary to $750,000 effective May 31, 2018; an annual base salary for Mr. Pope in 2016, 2017 and 2018; a pro-rated base salary for Mr. Meek, reflecting his appointment in April 2018; an annual base salary for Dr. Menon in 2016, 2017 and 2018; and a pro-rated base salary for Ms. Mericle, reflecting her appointment in May 2018.

(2) Mr. North became our President and Chief Executive Officer on May 31, 2016. As part of Mr. North's offer letter, he received a $1,500,000 sign in bonus and a contractually committed 2016 bonus of $472,450 as an inducement to join the Company. Mr. Meek joined our Company on April 2, 2018. As part of Mr. Meek's offer letter, he continued to participate in the Lifetouch Incentive Plan, of which $375,000 was guaranteed, regardless of actual performance. In connection with Ms. Mericle's appointment in May 2018, Ms. Mericle received a sign-on and transition bonus in the amount of $1,000,000 payable in two separate lump sum installments; the first, in the amount of $250,000, payable following her 30th day of employment and the second, in the amount of $750,000, payable following January 10, 2019.

(3) The amounts reported in this column represent the aggregate grant date fair value of RSUs and PBRSUs awarded to each NEO in the respective years computed in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718, Compensation—Stock Compensation. The grant date fair value for time-based RSUs is determined using the closing fair market value of our common stock on the date of grant. The grant date fair value of PBRSUs was calculated based on the probable outcome of the performance measures on the date of grant. For information regarding the assumptions used to calculate grant date fair value, see note 10 of the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018. The amounts reported in this column reflect stock-based compensation expense for these equity awards, and do not correspond to the actual value that may be recognized by each NEO.

(4) The amounts reported in this column represents the aggregate grant date fair value of stock options awarded to each NEO in 2016, 2017 and 2018. We estimated the fair value of each stock option award on the date of grant using the Black-Scholes option-pricing model and assumptions are included in our Annual Report on Form 10-K for the year ended December 31, 2018.

(5) The amounts reported in this column represent cash awards earned by each NEO under our 2016, 2017 and 2018 Quarterly Bonus Plans for our executive staff (other than Mr. Meek). the Lifetouch fiscal year ending June 30, 2018, Mr. Meek continued to participate in the existing Lifetouch Incentive Plan, with a guaranteed payment of at least $375,000 (50% of target) and any additional amounts up to $1,125,000 for maximum achievement subject to actual performance achievement under the terms of the Lifetouch Incentive Plan. In addition, for the "stub plan year" between July 1, 2018 and December 31, 2018, the Lifetouch Incentive Plan continued with the same maximum bonus target in place; however, we selected the performance metrics for the stub plan year. The 2018 Quarterly Bonus Plan and the Lifetouch Incentive Plan are described in greater detail in "Compensation Discussion and Analysis".

(6) As part of Mr. North's offer letter, he received $354,333 in relocation-related expenses in connection with his appointment as our CEO in 2016, which are included in the "All Other Compensation" column. In 2018, Mr. Meek was provided the benefit of driving a company-owned car and mileage driven for a benefit of $28,968 and a gross-up for federal and state income taxes of $24,243, a country club membership reimbursement for a benefit of $10,487 and an executive physical from the Mayo Clinic for a benefit of $9,647.

(7) On February 5, 2019, we announced that Mr. North will be stepping down as CEO at the end of August 2019, and that the Board has engaged an executive search firm to identify candidates to succeed him. On February 4, 2019, the Company entered into a Transition Agreement with Mr. North for transition services through August 31, 2019, pursuant to which Mr. North's 2018 performance-based RSUs were cancelled. Mr. North will receive his base salary as currently in effect and continue to vest in his outstanding stock options and time-based RSUs while he provides services during the Transition Period.

(8) On March 29, 2019, we entered into a transition agreement for transition services through October 15, 2019 with Mr. Meek, who will be stepping down as President and CEO of Lifetouch. For more information, see "Potential Payments upon Termination or Change of Control – Offer Letters and Potential Payments: Lifetouch CEO – Subsequent Development" below.

GRANTS OF PLAN-BASED AWARDS

The following table provides information on incentive awards granted to each NEO during the year ended December 31, 2018.

			ESTIMATED FUTURE PAYOUTS UNDER NON-EQUITY INCENTIVE PLAN AWARDS			ESTIMATED FUTURE PAYMENTS UNDER EQUITY INCENTIVE PLAN AWARDS				
NAME	TYPE OF AWARD	GRANT DATE	THRESHOLD ($)	TARGET ($)	MAXIMUM ($)	THRESHOLD (#)	TARGET (#)	MAXIMUM (#)	ALL OTHER STOCK AWARDS: NUMBER OF SHARES OF STOCK OR UNITS (#)	GRANT DATE FAIR VALUE OF STOCK AND OPTIONS AWARDS ($)(1)
Christopher North (2)	Cash (3)	—	—	750,000	1,500,000	—	—	—	—	—
	RSU (4)	8/13/2018	—	—	—	—	—	—	15,897	1,169,542
	RSU (5)	8/13/2018	—	—	—	—	31,806	63,612	—	2,339,967
Michael Pope	Cash (3)	—	—	225,000	450,000	—	—	—	—	—
	RSU (4)	2/28/2018	—	—	—	—	—	—	21,558	1,654,145
	RSU (4)	2/28/2018	—	—	—	—	—	—	11,977	918,995
	Options (6)	2/28/2018	—	—	—	—	—	—	57,276	1,349,904
Michael Meek (7)	Cash (3)	—	—	750,000	1,500,000	—	—	—	—	—
	RSU (4)	4/16/2018	—	—	—	—	—	—	12,324	1,011,307
	RSU (5)	9/4/2018	—	—	—	—	39,552	79,104	—	3,051,437
Satish Menon	Cash (3)	—	—	195,000	390,000	—	—	—	—	—
	RSU (4)	2/28/2018	—	—	—	—	—	—	15,170	1,163,994
	Options (6)	2/28/2018	—	—	—	—	—	—	40,305	949,924
Maureen Mericle	Cash (3)	—	—	182,500	365,000	—	—	—	—	—
	RSU (4)	10/1/2018	—	—	—	—	—	—	31,627	2,076,313
	RSU (4)	10/1/2018	—	—	—	—	—	—	7,028	461,388
	Options (6)	10/1/2018	—	—	—	—	—	—	114,039	2,249,761

(1) The amounts reported in this column represent the grant date fair value of each equity award computed in accordance with FASB ASC Topic 718. The grant date fair value for time-based RSUs is determined using the closing fair market value of the Company's common stock on the date of grant. The grant date fair value of stock options was calculated using the Black-Scholes option-pricing model. For information regarding the assumptions used to calculate grant date fair value, see note 10 of the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018. These amounts reflect our stock-based compensation expense for these awards, and do not correspond to the actual value that may be recognized by the NEOs.

(2) On February 5, 2019, we announced that Mr. North will be stepping down as CEO at the end of August 2019, and that the Board has engaged an executive search firm to identify candidates to succeed him. On February 4, 2019, the Company entered into a Transition Agreement with Mr. North for transition services through August 31, 2019, pursuant to which Mr. North's 2018 performance-based RSUs were cancelled. Mr. North will continue to vest in his other outstanding stock options and time-based RSUs while he provides services during the Transition Period.

(3) The amounts reported represent target and maximum aggregate annual cash awards payable to each NEO under our 2018 Quarterly Bonus Plan for executive staff. Each NEO could earn a range from 0% to 200% of the total target award (but subject to the overall pool funding cap of 125% of target). Actual payouts under the 2018 Bonus Plan were approved by the Committee on a quarterly basis based on our actual performance. The 2018 Quarterly Bonus Plan is described in greater detail in "Compensation Discussion and Analysis".

(4) The amounts reported represent RSUs subject to time-based vesting requirements granted under the 2015 Plan.

(5) The amounts reported represent RSUs that may be earned based upon achieving a pre-established performance level for the fiscal year ended December 31, 2020.

(6) The amounts reported represent stock options subject to time-based vesting requirements granted under the 2015 Plan.

(7) On March 29, 2019, we entered into a transition agreement for transition services through October 15, 2019 with Mr. Meek, who will be stepping down as President and CEO of Lifetouch. For more information, see "Potential Payments upon Termination or Change of Control – Offer Letters and Potential Payments: Lifetouch CEO – Subsequent Development" below.

The material terms of our 2018 Quarterly Bonus Plan necessary to an understanding of the possible aggregate cash awards payable to our NEOs, including the quarterly corporate performance measures under the plan, are described in "Compensation Discussion and Analysis" above under "Compensation Program Elements—Short-term Performance-based Incentive Program."

The material terms of the RSUs and stock options awarded to NEOs during 2018, including the vesting schedules applicable to the RSUs and stock options are described in "Compensation Discussion and Analysis."

OUTSTANDING EQUITY AWARDS AT YEAR-END

The following table provides information regarding equity awards held by each NEO as of December 31, 2018. No NEO has any other outstanding form of equity award.

NAME	GRANT DATE	NUMBER OF SHARES OR UNITS OF STOCK THAT HAVE NOT VESTED (#)	MARKET VALUE OF SHARES OR UNITS OF STOCK THAT HAVE NOT VESTED ($)(1)	EQUITY INCENTIVE PLAN AWARDS NUMBER OF UNEARNED SHARES OR OTHER RIGHTS THAT HAVE NOT VESTED (#)	EQUITY INCENTIVE PLAN AWARDS: MARKET OR PAYOUT VALUE OF UNEARNED SHARES, UNITS, OR OTHER RIGHTS THAT HAVE NOT VESTED ($)(1)	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS EXERCISABLE (#)	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS UNEXERCISABLE (#)	OPTION EXERCISE PRICE ($)	OPTION EXPIRATION DATE
Christopher North (2)	5/31/2016 (3)	60,000	2,415,600	—	—	—	—	—	—
	5/31/2016 (4)	—	—	—	—	378,958	301,042	48.30	5/30/2023
	8/13/2018 (5)	15,897	640,013	—	—	—	—	—	—
	8/13/2018 (6)	—	—	31,806	1,280,510	—	—	—	—
Michael Pope	10/27/2015 (5)	17,500	704,550	—	—	—	—	—	—
	10/27/2015 (5)	17,500	704,550	—	—	—	—	—	—
	2/14/2017 (4)	—	—	—	—	8,205	42,668	44.75	2/13/2024
	2/14/2017 (5)	17,625	709,583	—	—	—	—	—	—
	2/28/2018 (4)	—	—	—	—	—	57,276	76.73	2/27/2025
	2/28/2018 (5)	21,558	867,925	—	—	—	—	—	—
	2/28/2018 (7)	11,977	482,194	—	—	—	—	—	—
Michael Meek (8)	4/16/2018 (5)	12,324	496,164	—	—	—	—	—	—
	9/4/2018 (6)	—	—	39,552	1,592,364	—	—	—	—
Satish Menon	2/10/2016 (5)	12,428	500,351	—	—	—	—	—	—
	2/10/2016 (5)	12,428	500,351	—	—	—	—	—	—
	2/14/2017 (5)	14,250	573,705	—	—	—	—	—	—
	2/14/2017 (4)	—	—	—	—	5,308	34,497	44.75	2/13/2024
	2/14/2017 (7)	10,000	402,600	—	—	—	—	—	—
	2/28/2018 (4)	—	—	—	—	—	40,305	76.73	2/27/2025
	2/28/2018 (5)	15,170	610,744	—	—	—	—	—	—
Maureen Mericle	10/1/2018 (4)	—	—	—	—	—	114,039	65.65	9/30/2025
	10/1/2018 (5)	31,627	1,273,303	—	—	—	—	—	—
	10/1/2018 (7)	7,028	282,947	—	—	—	—	—	—

(1) Value is calculated by multiplying the number of RSUs that have not vested by the closing market price of our stock, $40.26, on December 31, 2018, the last trading day of 2018.

(2) On February 5, 2019, we announced that Mr. North will be stepping down as CEO at the end of August 2019, and that the Board has engaged an executive search firm to identify candidates to succeed him. On February 4, 2019, the Company entered into a Transition Agreement with Mr. North for transition services through August 31, 2019, pursuant to which Mr. North's 2018 performance-based RSUs were cancelled. Mr. North will continue to vest in his other outstanding stock options and time-based RSUs while he provides services during the Transition Period.

(3) The unvested shares subject to this RSU will vest on May 31, 2019, provided the NEO is still employed by us on such vesting date.

(4) The shares subject to this option grant will vest over four years, with 25% of such shares vesting one year after the grant date and 1/48th of such shares to vest monthly thereafter, provided the NEO is still employed by us on each such vesting date.

(5) The shares subject to this RSU vested or will vest in four equal annual installments on the anniversary of the grant date each year following the year of grant, provided the NEO is still employed by us on each such vesting date.

(6) The shares subject to this RSU will 100% vest three years from the grant date, assuming all performance obligations are met and the NEO is still employed by us on such vesting date.

(7) The shares subject to this RSU will 100% vest two years from the grant date, provided the NEO is still employed by us on such vesting date.

(8) On March 29, 2019, we entered into a transition agreement for transition services through October 15, 2019 with Mr. Meek, who will be stepping down as President and CEO of Lifetouch. For more information, see "Potential Payments upon Termination or Change of Control – Offer Letters and Potential Payments: Lifetouch CEO – Subsequent Development" below.

OPTION EXERCISES AND STOCK VESTED

The following table provides information regarding stock option exercises by our NEOs during the year ended December 31, 2018, and the number of shares issued to each NEO upon vesting of RSUs during 2018. Value realized on option exercise is calculated by subtracting the aggregate exercise price of the options exercised from the aggregate market value of the shares of Common Stock acquired on the date of exercise. Value realized on vesting of RSUs is based on the fair market value of our Common Stock on the vesting date multiplied by the number of shares vested and does not necessarily reflect proceeds received by the NEO.

	OPTION AWARDS		STOCK AWARDS	
NAME	NUMBER OF SHARES ACQUIRED ON EXERCISE	VALUE REALIZED ON EXERCISE ($)	NUMBER OF SHARES ACQUIRED ON VESTING	VALUE REALIZED ON VESTING ($)
Christopher North	170,000	3,308,702	50,000	4,707,000
Michael Pope	27,898	1,319,948	40,875	2,498,360
Michael Meek	—	—	—	—
Satish Menon	23,882	884,122	42,178	2,506,545
Maureen Mericle	—	—	—	—

CEO PAY RATIO

As required by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 402(u) of Regulation S-K, we are required to disclose the median of the annual total compensation of our employees (excluding our chief executive officer), the annual total compensation of our chief executive officer, Mr. North, and the ratio of these two amounts.

We have determined the 2018 annual total compensation of our median employee to be $76,839. The total 2018 compensation of Mr. North, as reported in the Summary Compensation Table above, was $4,481,337. Accordingly, the ratio of the 2018 annual total compensation of Mr. North to the 2018 annual total compensation of our median employee was approximately 58 to 1.

For the purposes of determining our CEO pay ratio in 2018, we are using the same median employee that we identified in 2017. We identified our median employee in 2017 by finding the median of the total compensation of our employees and examining taxable earnings from January 1, 2017 through October 31, 2017, as reported on W-2 forms, or the foreign equivalent, for all individuals employed by us as of October 31, 2017, other than our chief executive

officer. We included all employees, whether employed on a full-time, part-time, or seasonal basis, and we did not annualize the compensation of any full-time employees who were employed for less than the full calendar year. For purposes of identifying the median employee, we converted amounts paid in foreign currencies to U.S. dollars based on the applicable foreign exchange rate as of October 31, 2017. After excluding approximately 17,000 employees from Lifetouch, a company we acquired in fiscal year 2018, we believe there have been no changes to our employee population or employee compensation arrangements that would significantly affect our pay ratio disclosure.

We believe that the pay ratio reported above is a reasonable estimate calculated in a manner consistent with SEC rules based on our internal records and the methodology described above.

POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE OF CONTROL

We have entered into termination of employment and change-in-control arrangements with our Named Executive Officers as summarized below:

Offer Letters and Potential Payments: CEO

Christopher North. Mr. North's offer letter with Shutterfly provides that if Mr. North's employment with Shutterfly is terminated without cause (as defined in the offer letter) or he resigns his employment for good reason (as defined in the offer letter), whether or not in connection with a change in control (as defined in the offer letter) of Shutterfly, then Mr. North will be entitled to receive, conditioned on execution by Mr. North of a release of claims in favor of Shutterfly:

- A lump sum cash payment equal to 12 months of his then-current base salary;
- A lump sum payment equal to 100% of his target bonus (assuming target achievement for the then-current fiscal year);
- A lump sum payment equal to the applicable COBRA payments for 18 months;
- Acceleration of all then-unvested shares subject to the RSU granted to Mr. North upon employment pursuant to the terms of his offer letter; and
- Acceleration of the number of then-unvested shares subject to the option granted to Mr. North pursuant to the terms of his offer letter (the "North Option") that would have vested during the next 12 months.

If Mr. North's employment with Shutterfly is terminated without cause (as defined in the offer letter) or he resigns his employment for good reason (as defined in the offer letter) within 90 days before or 12 months of a change in control (as defined in the offer letter) of Shutterfly, then Mr. North will be entitled to receive the same benefits as described above plus (i) a 12 month period in which to exercise any vested portion of the North Option and (ii) if the termination occor (y) after May 31, 2018, acceleration of all then-unvested shares subject to the North Option. Receipt of these severance benefits is conditioned on execution by Mr. North of a release of claims in favor of the Company.

In connection with Mr. North's termination of employment for any reason, Mr. North's offer letter also provides for payment of any earned but unpaid base salary, the amount of any Actual Bonus (as defined in Mr. North's offer letter) earned and payable from a prior bonus period which remains unpaid by Shutterfly as of the date of the termination (except in the case of termination for cause), other unpaid and then-vested amounts, and reimbursement for all reasonable and necessary expenses incurred in connection with his performance of services on behalf Shutterfly.

In August 2018, the Board approved the grant of time-based RSU awards and performance-based RSU awards to Mr. North to motivate him to drive financial performance. If Mr. North's service had been terminated by Shutterfly without cause or by Mr. North for good reason (each as defined in Mr. North's offer letter) not in connection with a change in control, Mr. North would have been entitled to receive the acceleration of 12 months of the then-unvested shares subject to his time-based RSUs and performance-based RSUs at the target EBITDA threshold. If Mr. North's service had been terminated by Shutterfly without cause or by Mr. North for good reason (each as defined in Mr. North's offer letter) within 12 months following the consummation of a change in control (as defined in Mr. North's offer letter), Mr. North would have been entitled to receive the acceleration of all of the then-unvested shares subject to his time-based RSUs and performance-based RSUs at the target EBITDA threshold. See "Subsequent Development" below.

The following table summarizes the potential payments and benefits payable to Mr. North upon termination of employment or a qualifying termination in connection with a change in control under each situation listed below, modeling, in each situation, that Mr. North was terminated on December 31, 2018.

				FOLLOWING A CHANGE IN CONTROL	
EXECUTIVE BENEFITS AND PAYMENTS UPON TERMINATION	VOLUNTARY TERMINATION FOR CAUSE	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON
Base Salary	$—	$ 750,000	$ 750,000	$ 750,000	$ 750,000
Bonus	—	—	—	—	—
Health Benefits (1)	—	36,749	36,749	36,749	36,749
Value of Accelerated Stock Options	—	—	—	—	—
Value of Accelerated Restricted Stock Units	—	2,575,634	2,575,634	4,336,123	4,336,123

(1) This amount reflects our maximum 18-month obligation. If Mr. North became covered by another employer's health plan during such 18-month period, then our obligation to pay Mr. North's health plan coverage shall cease.

Subsequent Development

On February 5, 2019, we announced that Mr. North will be stepping down from his role as the Company's President and Chief Executive Officer and as a member of the Board at the end of August 2019 in order to return to the United Kingdom with his family, and that the Board has engaged an executive search firm to identify candidates to succeed him. On February 4, 2019, the Company entered into a Transition Agreement (the "Transition Agreement") with Mr. North, pursuant to which he will provide transition services through the Transition Period. In connection with his execution of the Transition Agreement, Mr. North's 2018 performance-based RSUs were cancelled and Mr. North will not be eligible to participate in the Company's 2019 corporate bonus program. Mr. North will continue to receive his base salary as currently in effect and continue to vest in his outstanding stock options and time-based RSUs during the Transition Period.

Upon Mr. North's termination at the end of the Transition Period, or if prior to the end of the Transition Period, Mr. North's employment with the Company is terminated by the Company other than for cause (as defined in the Transition Agreement) or Mr. North resigns at the written request of the Company that is not for cause (each such event, a "Qualifying Termination"), subject to Mr. North's execution of a general release of claims, Mr. North will be entitled to receive (i) a lump-sum payment of $750,000, *less* the salary (gross) paid to Mr. North for his service from January 1, 2019 through his termination date; (ii) a lump-sum transition bonus payment of $562,000; and (iii) a lump sum payment equal to 18 months of COBRA premiums for Mr. North and his covered dependents. In addition, if Mr. North experiences a Qualifying Termination prior to the end of the Transition Period, Mr. North's stock options and time-based RSUs will vest as to such number of shares that would have vested if he had remained employed for the duration of the Transition Period. In the event that Mr. North's employment terminates due to his death or disability before the end of the Transition Period, he will be entitled to receive the transition bonus payment and the vesting of his stock options and time-based RSUs will vest as to such number of shares that would have vested had Mr. North remained employed and continued to provide the Transition Services for an additional 12 months.

If a Change in Control (as defined in the Transition Agreement) occurs during the Transition Period, and Mr. North's employment terminates at the end of the Transition Period or an earlier Qualifying Termination, the vesting of Mr. North's then-outstanding stock options and time-based RSUs will accelerate in full, to the extent provided in the terms of his options and RSUs. If a Change in Control occurs within 90 days following Mr. North's completion of the Transition Period or

an earlier Qualifying Termination, Mr. North's then-outstanding stock options and the RSUs granted in 2016 will accelerate in full, to the extent provided in the terms of his options and RSUs.

Mr. North's vested stock options will remain exercisable until the earlier of 12 months following the date of his termination and the original expiration date of such options.

Offer Letters and Potential Payments: Lifetouch CEO

Michael Meek. Mr. Meek's employment offer letter with Shutterfly (i) assumes the terms and conditions of his prior Change in Control Severance Agreement (the "CIC Agreement") with Lifetouch (modified to reflect the acquisition by Shutterfly) and (ii) provides for additional payments and benefits in the event of an involuntary termination of employment between the second and third anniversary of the effective date of the Lifetouch acquisition. Specifically, under the assumed terms, if Mr. Meek's employment is terminated without cause (as defined in the CIC Agreement) or he resigns his employment for good reason (as defined in the CIC Agreement) prior to April 2, 2020, whether or not in connection with another change in control of Lifetouch, then Mr. Meek will be entitled to received, conditioned on his execution of a release of claims in favor of Shutterfly:

- A lump sum cash payment equal to two times the sum of (i) his base salary (as defined in the CIC Agreement) plus (ii) his target incentive bonus (as defined in the CIC Agreement);
- A lump sum payment equal to the applicable employer portion of COBRA payments for 24 months; and
- 12 months of executive-level outplacement services with a provider selected by us.

If Mr. Meek's employment with Lifetouch is terminated without cause (as defined in the Meek Offer Letter) after April 2, 2020 but before April 2, 2021, then Mr. Meek will be entitled to receive, conditioned on his execution of a release of claims in favor of Shutterfly:

- A lump sum cash payment equal to 24 months of his then-current base salary;
- The applicable employer portion of COBRA payments for up to 24 months; and
- 12 months of executive-level outplacement services with a provider selected by us.

If Mr. Meek's employment is terminated for any reason other than cause prior to the payment of his retention bonus of $1,500,000 (payable on the second anniversary of the effective date of the Lifetouch acquisition), such bonus shall be pro-rated based on the number of months Mr. Meek was employed by Lifetouch and Shutterfly following the effective date of the Lifetouch acquisition. If Mr. Meek voluntarily resigns his position or his employment is terminated for cause prior to the payment of the retention bonus, the bonus is forfeited.

On September 29, 2017, Lifetouch entered into a Time-Based Phantom Stock Unit Agreement and a Performance-Based Phantom Stock Unit Agreement with Mr. Meek. The Company assumed payment of obligations in respect of the units granted under these agreements in its acquisition of Lifetouch. Due to Shutterfly's acquisition of Lifetouch, a specified number of units were deemed earned and subject to a four-year vesting schedule, with the earned units subject to the awards vesting in four equal annual installments on each anniversary of the grant date, contingent on Mr. Meek's continued employment through each applicable vesting date. In the event of an involuntary termination without cause or voluntary termination for good reason, all of the then-unvested units would accelerate. Payment in respect of vested units is the earliest of the December 15th following Mr. Meek's separation from service or December 15, 2021.

The following table summarizes the potential payments and benefits payable to Mr. Meek upon termination of employment or a qualifying termination in connection with a change in control under each situation listed below, modeling, in each situation that Mr. Meek was terminated on December 31, 2018. The table is pursuant to the terms set forth in the Meek Offer Letter and the Phantom Stock Agreements.

				FOLLOWING A CHANGE IN CONTROL	
EXECUTIVE BENEFITS AND PAYMENTS UPON TERMINATION	VOLUNTARY TERMINATION FOR CAUSE	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON
Base Salary	$ —	$1,500,000	$1,500,000	$1,500,000	$1,500,000
Bonus	—	1,500,000	1,500,000	1,500,000	1,500,000
Retention Bonus (1)		562,500	562,500	562,500	562,500
Health Benefits	—	33,600	33,600	33,600	33,600
Outplacement Services		25,000	25,000	25,000	25,000
Value of Accelerated Phantom Stock Units	375,120	1,500,479	1,500,479	1,500,479	1,500,479
Value of Accelerated Stock Options	—	—	—	—	—
Value of Accelerated Restricted Stock Units	—	—	—	—	—

(1) This figure reflects a pro-rated amount based on the number of months Mr. Meek is employed by Lifetouch and Shutterfly following the effective date of the Lifetouch acquisition.

Subsequent Development

On March 29, 2019, we entered into a Transition Agreement (the "Meek Transition Agreement") for transition services through October 15, 2019 (the "Meek Transition Period") with Mr. Meek, who will be stepping down from his role as the President and Chief Executive Officer of Lifetouch to pursue other activities. Pursuant to the Meek Transition Agreement, Mr. Meek's termination of employment constitutes "Good Reason" (as defined in the CIC Agreement) and he will continue to receive his base salary as currently in effect while he provides services during the Meek Transition Period.

Upon Mr. Meek's termination of employment at the end of the Meek Transition Period, or if prior to the end of the Meek Transition Period, Mr. Meek's employment with the Company is terminated by the Company other than for cause (as defined in the Meek Transition Agreement), subject to Mr. Meek's execution of a general release of claims, Mr. Meek will be entitled to receive (a) a lump sum cash payment equal to two (2) times the sum of (i) his base salary, plus (ii) his target incentive bonus at the time of the Lifetouch acquisition, (b) a lump sum cash payment equal to the applicable employer portion of health benefit and insurance premium payments for 24 months; and (c) 12 months of executive-level outplacement services with a provider selected by us.

Mr. Meek will be entitled to a prorated portion of the retention bonus he was granted, based on the number of months Mr. Meek is employed by Lifetouch and Shutterfly following the effective date of the Lifetouch acquisition. Pursuant to the terms of certain obligations the Company assumed in its acquisition of Lifetouch and upon separation of employment, Mr. Meek will be entitled to the accelerated vesting of phantom stock awards made by Lifetouch in September 2017; this payment will be made on or about December 15, 2019.

Executive Retention Agreements: Other NEOs

The Board approved management to negotiate and prepare retention agreements for our incumbent-NEOs other than our Chief Executive Officer (the "Retention Agreements"), to provide them with certain severance benefits in the event that their employment is terminated under specified circumstances, as set forth in the Retention Agreements. Additionally, each Retention Agreement supersedes in full the terms

and provisions of the offer letters, as amended, of the incumbent-NEOs (other than our Chief Executive Officer) as it relates to certain terms and benefits resulting from a change in control of Shutterfly.

Unless otherwise renewed, the Retention Agreements will terminate on the earlier of:

- The third anniversary of the CIC Qualifying Termination Effective Date (the "Expiration Date"); or
- The date the NEO's employment with the Company terminates for a reason other than a Qualifying Termination or CIC Qualifying Termination; provided however, that if a definitive agreement relating to a change in control (as defined in the Retention Agreement) has been signed by Shutterfly on or before the Expiration Date, then the Retention Agreement will remain in effect through the earlier of:
    - The date the NEO's employment with Shutterfly terminates for a reason other than a Qualifying Termination or CIC Qualifying Termination; or
    - The date Shutterfly or its successor has met all of its obligations under the Retention Agreement following a termination of the NEO's employment with Shutterfly due to a Qualifying Termination or CIC Qualifying Termination.

The Retention Agreements will renew automatically and continue in effect for three-year periods measured from the initial Expiration Date and each subsequent Expiration Date unless the Company provides the NEO notice of non-renewal at least three months prior to the date on which the Retention Agreement would otherwise renew.

Termination Not in Connection with a Change in Control

If the NEO's service is terminated by Shutterfly without Cause or by the NEO for Good Reason (each as defined in the Retention Agreement) during the term of the Retention Agreement, the NEO would be entitled to receive the following benefits, subject to his or her execution of a general release of claims:

- Lump sum cash severance payment equal to six months (12 months if the termination occurs between April 1, 2019 and April 1, 2020) of the NEO's base salary for the year during which the termination occurs;
- Acceleration of that number of the NEO's equity awards equal to a number of shares subject to each equity award calculated by multiplying 50% (100% if the termination occurs between April 1, 2019 and April 1, 2020) by the number of shares subject to such equity award that would have vested had the NEO completed an additional 12 months of service following the termination date, including any performance-based awards (subject to actual achievement and certification of the applicable performance criteria); and
- Continued employee benefits whereby Shutterfly will pay the NEO's COBRA premiums for continuation of all health, dental and vision plans for the NEO and his/her dependents for up to six months (12 months if the termination occurs between April 1, 2019 and April 1, 2020).

Termination in Connection with a Change in Control

If within 12 months following the consummation of a Change in Control of Shutterfly (as defined in the Retention Agreement), the NEO's service is terminated by the Company or its successor without Cause (as defined in the Retention Agreement) or by the NEO for Good Reason (as defined in the Retention Agreement), the NEO would be entitled to receive the following benefits, subject to the NEO's execution of a general release of claims:

- Lump sum cash severance payment equal to 12 months' base salary for the year during which the termination occurs;
- Acceleration of 100% of the NEO's unvested equity awards; and
- Continued employee benefits whereby Shutterfly or its successor will pay the NEO's COBRA premiums for continuation of all health, dental and vision plans for up to 12 months.

Michael Pope. The following table summarizes the potential payments and benefits payable to Mr. Pope upon termination of employment or a qualifying termination in connection with a change in control under each situation listed below, modeling, in each situation that Mr. Pope was terminated on December 31, 2018. The table is pursuant to the terms set forth in Mr. Pope's offer letter and the Retention Agreement, as applicable (each as set forth above).

				FOLLOWING A CHANGE IN CONTROL	
EXECUTIVE BENEFITS AND PAYMENTS UPON TERMINATION	VOLUNTARY TERMINATION FOR CAUSE	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON
Base Salary	$—	$225,000	$225,000	$ 450,000	$ 450,000
Bonus	—	—	—	—	—
Health Benefits (1)	—	12,250	12,250	24,499	24,499
Value of Accelerated Stock Options	—	—	—	—	—
Value of Accelerated Restricted Stock Units	—	931,314	931,314	3,468,802	3,468,802

(1) This amount reflects our maximum obligation. If Mr. Pope became covered by another employer's health plan during the 6 or 12 month period, as applicable, then our obligation to pay Mr. Pope's health plan coverage shall cease.

Maureen Mericle. The following table summarizes the potential payments and benefits payable to Ms. Mericle upon termination of employment or a qualifying termination in connection with a change in control under each situation listed below, modeling, in each situation that Ms. Mericle was terminated on December 31, 2018. The table is pursuant to the terms set forth in Ms. Mericle's offer letter and the Retention Agreement, as applicable (each as set forth above).

				FOLLOWING A CHANGE IN CONTROL	
EXECUTIVE BENEFITS AND PAYMENTS UPON TERMINATION	VOLUNTARY TERMINATION FOR CAUSE	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON
Base Salary	$—	$182,500	$182,500	$ 365,000	$ 365,000
Bonus	—	—	—	—	—
Health Benefits (1)	—	10,224	10,224	20,447	20,447
Value of Accelerated Stock Options	—	—	—	—	—
Value of Accelerated Restricted Stock Units	—	159,168	159,168	1,556,250	1,556,250

(1) This amount reflects our maximum obligation. If Ms. Mericle became covered by another employer's health plan during the 6 or 12-month period, as applicable, then our obligation to pay Ms. Mericle's health plan coverage shall cease.

Satish Menon. The following table summarizes the potential payments and benefits payable to Dr. Menon upon termination of employment or a qualifying termination in connection with a change in control under each situation listed below, modeling, in each situation that Dr. Menon was terminated on December 31, 2018. The table is pursuant to the terms set forth in Dr. Menon's offer letter and the Retention Agreement, as applicable (each as set forth above).

				FOLLOWING A CHANGE IN CONTROL	
EXECUTIVE BENEFITS AND PAYMENTS UPON TERMINATION	VOLUNTARY TERMINATION FOR CAUSE	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON	INVOLUNTARY TERMINATION NOT FOR CAUSE	TERMINATION FOR GOOD REASON
Base Salary	$—	$195,000	$195,000	$ 390,000	$ 390,000
Bonus	—	—	—	—	—
Health Benefits (1)	—	12,250	12,250	24,499	24,499
Value of Accelerated Stock Options	—	—	—	—	—
Value of Accelerated Restricted Stock Units	—	623,446	623,446	2,587,752	2,587,752

(1) This amount reflects our maximum obligation. If Dr. Menon became covered by another employer's health plan during the 6 or 12-month period, as applicable, then our obligation to pay Dr. Menon's health plan coverage shall cease.

DIRECTOR COMPENSATION

The following table provides compensation information for each person who served as a director during fiscal 2018, except for Mr. North who did not receive any compensation for his service as a member of the Board. Mr. North's compensation is summarized in the "Compensation Discussion and Analysis" and "Compensation Tables" above.

	YEAR ENDED DECEMBER 31, 2018		
NAME	**FEES EARNED OR PAID IN CASH** ($)	**STOCK AWARDS** ($)(1)	**TOTAL** ($)
Thomas D. Hughes	—	224,952	224,952
William J. Lansing (2)	42,500	309,871	352,371
Eva Manolis	—	224,952	224,952
Ann Mather	—	224,952	224,952
Elizabeth S. Rafael (3)	15,000	259,913	274,913
Elizabeth Sartain (4)	10,000	244,916	254,916
H. Tayloe Stansbury	—	224,952	224,952
Brian T. Swette (5)	10,000	224,952	234,952
Michael P. Zeisser	—	224,952	224,952

(1) The amount in this column represents the aggregate grant date fair value of stock awards granted to each director during 2018 computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718. For more information regarding the assumptions used to calculate grant date fair value, see note 10 of our notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2018. These amounts reflect our stock-based compensation expense for these awards, and do not correspond to the actual value that may be recognized by each director. As of December 31, 2018, the above-listed directors held outstanding unvested shares of common stock subject to RSU awards under which the following shares of our Common Stock are issuable: Mr. Hughes 2,400; Mr. Lansing 3,306; Ms. Manolis 2,400; Ms. Mather 2,400; Ms. Rafael 2,773; Ms. Sartain 2,613; Mr. Stansbury 2,400; Mr. Swette 2,400; Mr. Zeisser 2,400.

(2) Mr. Lansing received $42,500 for his service as chairperson of the Board in 2018.

(3) Ms. Rafael received $15,000 for her service as chairperson of the Audit Committee.

(4) Ms. Sartain received $10,000 for her service as chairperson of the Compensation and Leadership Development Committee.

(5) Mr. Swette received $10,000 for his services as chairperson of the Governance Committee.

Cash Compensation. Each of our non-employee directors who is not affiliated with one of our major stockholders who serves as a chairperson of a Board committee receives the following annual cash retainer, paid in quarterly installments, for each year of such service: for service as the chairperson of the Audit Committee, $15,000; for chairperson of the Compensation and Leadership Development Committee, $10,000; for chairperson of the Governance Committee, $10,000. The Chairman of the Board of Directors receives an annual cash retainer of $42,500.

Restricted Stock Unit Awards. Each of our non-employee directors receives an annual restricted stock unit ("RSU") award worth $225,000 as determined based on the closing price of our Common Stock on the date of the Annual Meeting. In addition, the Chairman of the Board receives an additional annual RSU award worth $85,000, the chair of the Audit Committee receives an additional annual RSU award worth $35,000, and the chair of the Compensation and Leadership Development Committee receives an additional RSU award worth $20,000, each as determined based on the closing price of our Common Stock on the date of the Annual Meeting. Both the annual awards and the additional awards for chair positions are subject to vesting over a one-year period from the date of grant. Based on a May to May term cycle for all directors, if a new Board member is appointed at any other time during the year, the annual RSU awards are prorated based on the term of service for that year.

Following the 2018 Annual Meeting held on May 23, 2018, we granted each of our non-employee directors an annual RSU award for his or her service as a director of the Company valued at $225,000. In each such case, the RSU awards were valued based on the closing price of our Common Stock on May 23, 2018 of $93.73 per share and granted pursuant to the terms and conditions of our 2015 Plan.

Other. In addition, to encourage our board members to experience, test and become familiar with the Company's products, our board members receive the same merchandise discount codes as our employees.

PROPOSAL NO. 3 AMENDMENT OF 2015 EQUITY INCENTIVE PLAN

We are asking stockholders to approve an amendment to our 2015 Equity Incentive Plan (the "2015 Plan") to add 1,000,000 shares of our common stock to the total number of shares reserved for issuance under the 2015 Plan (the "2015 Plan Amendment"). Our Board recommends stockholders approve the amendment to the 2015 Plan to promote our long-term growth and profitability by aligning the interests of our key employees with those of other stockholders and providing additional incentives to enhance stockholder value. The Company also intends to make certain modifications to the 2015 Plan to reflect recent changes in applicable tax laws resulting from the Tax Cuts and Jobs Act of 2017, that reflect the repeal of certain provisions related to Section 162(m) of the Internal Revenue Code.

Our Board believes the company's success is due to its highly talented employee base and that future success depends on our ability to continue attracting and retaining high-caliber employees. Our operations are primarily located in Silicon Valley, where we compete with many technology companies, including high profile start-ups, for a limited pool of talented people. Our ability to grant equity awards is a necessary and powerful recruiting and retention tool to maintain and create stockholder value. Non-approval of the Plan Amendment may compel us to increase the cash component of employee compensation because the Company would need to replace components of compensation previously delivered in equity awards.

We designed the 2015 Plan with the intent to exhibit best practices in equity compensation plans. The 2015 Plan was initially approved by stockholders on December 18, 2015 and reserved a total of 1,400,000 shares of Common Stock thereunder and replaced our prior 2006 Equity Incentive Plan. Our Board and stockholders approved an increase to the shares reserved under the 2015 Plan by 1,300,000 shares and 900,000 shares in May 2017 and May 2018, respectively. The 2015 Plan includes features designed to address stockholder concerns related to equity incentive plan governance such as prohibiting repricing without stockholder approval, eliminating "evergreen" share replenishment features, no single trigger vesting acceleration, and an annual limit on non-employee director compensation.

The 2015 Plan is our only active employee equity plan. As of March 18, 2019, we anticipate that the 1,000,000 shares requested under the 2015 Plan Amendment, plus approximately 900,000 shares available for issuance under the 2015 Plan prior to amendment will enable the Company to fund equity compensation program through the date of our 2020 Annual Meeting, accommodating anticipated grants relating to the hiring, retention and promotion of employees, including a new Chief Executive Officer. The proposed increase represents approximately 2.9% of the total shares of common stock outstanding as of the record date.

Our Committee (which administers our equity plans) recognizes its responsibility to strike a balance between the potential dilutive effect of equity awards and the ability to attract, retain and reward employees whose contributions are critical to the long-term success of the company. In administering our equity compensation program, the Committee considers our annual "stockholder value transfer" or "SVT." We define SVT as the aggregate grant date fair value of equity compensation awards granted during the year divided by the weighted average market capitalization at the time of grant.

We have actively managed our annual stockholder value transfer lower over the prior three years to a level that we believe is competitive with our peer group of technology companies, even while recruiting a new CEO, CFO, SVP of Enterprise, President, Shutterfly Consumer and SVP of Marketing and most recently our SVP Chief Marketing Officer over the last four years. We anticipate that our 2019 SVT will be 4.08% compared to an average of 3.42% over 2016-2018 due to the estimated new hire grant for our new Chief Executive Officer, the addition of Lifetouch employees and our lower share price as compared to 2018. We recognize that proxy advisory groups use the broad retail sector for assessing our equity compensation practices. Although Shutterfly is classified in a narrow sub-industry within this sector (Internet and Catalog Retail), we do not believe the retail sector is the appropriate frame of reference for evaluating our equity compensation program. Retail companies tend to place more emphasis on cash compensation and grant to a smaller portion

of their employees than technology companies like Shutterfly, and therefore exhibit lower use of equity compensation. We continually evaluate the competitiveness of our compensation programs on a holistic basis and believe our use of equity compensation is competitive with the companies with which we compete for talent.

SHUTTERFLY SVT: ACTUAL 2015-2018 AND EXPECTED 2019

SHUTTERFLY STOCKHOLDER VALUE TRANSFER (“SVT”)

	ACTUAL				PROJECTED
	2015	2016	2017	2018	2019*
(a) RSUs/PBRSUs Granted	2,412,000	1,312,000	821,000	810,000	1,390,000
(b) Stock Options Granted	—	850,000	614,000	342,000	—
(c) Option Black-Scholes %	—	28.0%	27.0%	30.5%	—
(d) Avg. Common Shares Outstanding	36,761,000	34,097,000	33,113,000	33,258,000	34,066,000
(e) **SVT** **((a + b x c) ÷ d)**	**6.56%**	**4.54%**	**2.98%**	**2.75%**	**4.08%**

* Projected fiscal year 2019 includes estimated CEO new hire grant.

SHUTTERFLY SVT VS. PEERS

3-YEAR AVERAGE SVT	
Peer 75th Percentile	4.47%
Peer Median	3.07%
Peer 25th Percentile	2.04%
Shutterfly (2016-2018)	3.39%
Shutterfly Expected 2019	4.08%

We also note that historically our share repurchase program elevated our “burn rate” percentage as reported by proxy advisory groups in recent years. Over the course of fiscal 2016 and 2017, we repurchased approximately 4.9 million shares of our common stock from the market (not counting shares delivered by employees in satisfaction of tax withholding obligations). Importantly, we believe these shares repurchases have returned value to our stockholders and have mitigated the dilutive effect of our equity grants. However, the repurchases caused our total number of shares outstanding during this period to decrease by approximately 13.9%. We believe that the benefits of our share repurchase program outweighed any impact the lower number of shares outstanding may have had on “burn rate” or similar calculations.

Our Board adopted the 2015 Plan Amendment on April 2, 2019, subject to approval by stockholders. If stockholders do not approve the 2015 Plan Amendment, no shares will be added to the number of shares reserved for issuance under the 2015 Plan and no other amendment described above will take effect.

A summary of the principal provisions of the 2015 Plan is set forth below. The summary is qualified by reference to the full text of the 2015 Plan, a copy of which is attached as Appendix A to this Proxy Statement.

SUMMARY OF THE 2015 PLAN

Purpose. The purpose of the 2015 Plan is to provide incentives to attract, retain and motivate eligible persons whose present and potential contributions are important to the success of Shutterfly, and any parents and subsidiaries that exist now or in the future, by offering them an opportunity to participate in Shutterfly's future performance through the grant of awards under the 2015 Plan.

Shares Reserved for Issuance Under the 2015 Plan. As of the date the 2015 Plan Amendment is approved by Shutterfly's stockholders, the total number of shares reserved for issuance under the 2015 Plan will be 14,210,777 shares (and will increase to 15,210,777 if the Plan Amendment is approved). No more than 3,600,000 shares may currently be issued pursuant to the exercise of incentive stock options; this number would increase to 4,600,000 if the Plan Amendment is approved by stockholders. The shares may be authorized but unissued or reacquired shares.

In addition, shares will again be available for grant and issuance under our 2015 Plan that are subject to (i) issuance upon exercise of any option or SAR granted under our 2015 Plan or 2006 Plan and that cease to be subject to the option or SAR for any reason other than exercise of the option or the SAR, (ii) an award granted under our 2015 Plan or 2006 Plan that is subsequently forfeited or repurchased by us at the original issue price, or (iii) an award granted under our 2015 Plan that otherwise terminates without shares being issued.

Awards issued as an option or SAR will reduce the number of shares available for issuance by the number of shares underlying the award, regardless of the number of shares actually issued upon exercise of the award. The following shares will not again be made available for future grant under the 2015 Plan: shares that are withheld to pay the exercise or purchase price of an award or to satisfy any tax withholding obligations in connection with an option or SAR, shares not issued or delivered as a result of the net settlement of an outstanding option or SAR, or shares of Shutterfly's common stock repurchased on the open market with the proceeds of an option exercise price. Shutterfly may substitute or assume outstanding awards granted by another company, whether in connection with an acquisition of such other company or otherwise, by either granting an award under the 2015 Plan in substitution of such other company's award or assuming such award as if it had been granted under the 2015 Plan. Substitute awards will not reduce the number of shares authorized for grant under the 2015 Plan or authorized for grant to a participant in any calendar year.

As of March 18, 2019, approximately 1,220 employees and 9 non-employee directors are eligible to participate in the 2015 Plan under our current participation guidelines. As of March 18, 2019, the closing price of our common stock was $40.89 per share.

Equitable Adjustments. The Committee retains the discretion to make certain equitable adjustments. If the number of outstanding shares is changed by a stock dividend, recapitalization, stock split, reverse stock split, subdivision, combination, reclassification or similar change in the capital structure of Shutterfly, without consideration, then (i) the number of shares reserved for issuance and future grant under the 2015 Plan, (ii) the exercise prices of and number of shares subject to outstanding options and SARs, (iii) the number of shares subject to other outstanding awards, (iv) the maximum number of shares that may be issued as incentive stock options, and (v) the maximum number of shares that may be issued to an individual in any one calendar year, shall be proportionately adjusted, subject to any required action by the Board or the stockholders of Shutterfly.

Plan Administration. The 2015 Plan is administered by our Committee, all of the members of which are non-employee directors under applicable federal securities laws and outside directors as defined under applicable federal tax laws. However, the Board will establish the terms for the grant of an award to non-employee directors. The Committee has the authority to construe and interpret the 2015 Plan, grant awards and make all other determinations necessary or advisable for the administration of the 2015 Plan.

Eligibility. Employees, officers, directors, consultants, independent contractors and advisors of Shutterfly or any parent or subsidiary of Shutterfly are eligible to receive awards. Only our employees and those of any parent or subsidiary of Shutterfly, including officers and directors who are also employees, are eligible to receive incentive stock options.

Awards. The 2015 Plan authorizes the award of stock options, restricted stock awards, stock appreciation rights, restricted stock units, stock bonuses and performance awards (which may consist of performance shares, performance units, or performance cash). The terms of an award will be set forth in an individual award agreement, which may be in electronic form.

Annual Limits. No participant will be eligible for the grant of more than 1,000,000 shares in any calendar year under the 2015 Plan except that new employees are eligible for the grant of up to a maximum of 2,000,000 shares in the calendar year in which they commence their employment. No participant will be eligible for the grant of more than $10,000,000 in performance awards denominated in cash in any calendar year under the 2015 Plan. In addition, the aggregate value of cash and equity compensation granted to a non-employee director in any calendar year will not, pursuant to Section 12 of the 2015 Plan, exceed $750,000.

Performance Factors. The vesting of awards granted under the 2015 Plan may be subject to performance factors. Performance factors means the factors selected by the Committee from among the following measures, either individually or in any combination, applied to Shutterfly as a whole or any business unit or subsidiary, on a GAAP or non-GAAP basis, and measured, to the extent applicable, on an absolute basis or relative to a pre-established target, index, or other companies, to determine whether the performance goals established by the Committee with respect to applicable awards have been satisfied:

Profit Before Tax; Sales; Expenses; Billings; Revenue; Net revenue; Earnings (which may include earnings before interest and taxes, earnings before taxes, net earnings, stock-based compensation expenses, depreciation and amortization); Operating income; Operating margin; Operating profit; Controllable operating profit, or net operating profit; Net Profit; Gross margin; Operating expenses or operating expenses as a percentage of revenue; Net income; Earnings per share; Total stockholder return; Market share; Return on assets or net assets; Shutterfly's stock price; Growth in stockholder value relative to a pre-determined index; Return on equity; Return on invested capital; Cash Flow (including free cash flow or operating cash flows); Balance of cash, cash equivalents and marketable securities; Cash conversion cycle; Economic value added; Individual confidential business objectives; Contract awards or backlog; Overhead or other expense reduction; Credit rating; Completion of an identified special project; Completion of a joint venture or other corporate transaction; Strategic plan development and implementation; Succession plan development and implementation; Improvement in workforce diversity; Employee satisfaction; Employee retention; Customer indicators and satisfaction; New product invention or innovation; Research and development expenses; Attainment of research and development milestones; Improvements in productivity; Bookings; Working-capital targets and changes in working capital; and Attainment of objective operating goals and employee metrics.

The Committee may, in recognition of unusual or non-recurring items such as acquisition-related activities or changes in applicable accounting rules, provide for one or more equitable adjustments (based on objective standards) to the performance factors to preserve the Committee's original intent regarding the performance factors at the time of the initial award grant. It is within the sole discretion of the Committee to make or not make any such equitable adjustments.

Transferability. Generally, awards granted under the 2015 Plan may not be transferred.

Prohibition on Repricing. Other than pursuant to section 2.4 of the 2015 Plan that addresses equitable adjustments, the Committee will not without the approval of Shutterfly's stockholders, (i) lower the exercise price per share of an option or SAR after it is granted, (ii) cancel an option or SAR when the exercise price per share exceeds the fair market value of one share in exchange for cash or another award (other than in connection with a corporate transaction pursuant to section 21 of the 2015 Plan), or (iii) take any other action with respect to an option or SAR that would be treated as a repricing under the rules and regulations of the principal U.S. national securities exchange on which the shares are listed.

Insider Trading; Clawback Policy. Each participant who receives an award will comply with any policy adopted by Shutterfly from time to time covering transactions in Shutterfly's securities by employees, officers and/or directors of Shutterfly. All awards will be subject to clawback or recoupment pursuant to any compensation clawback or recoupment policy adopted by the Board or required by law during the term of the participant's employment or other service with Shutterfly, and in addition to any other remedies available under such policy and applicable law, may require the cancellation of outstanding awards and the recoupment of any gains realized with respect to awards.

Amendment or Termination. Our Board may at any time terminate or amend the 2015 Plan in any respect, including, without limitation, amendment of any form of award agreement or instrument to be executed pursuant to the 2015 Plan; *provided, however*, that the Board will not, without the approval of our stockholders, amend the 2015 Plan in any manner that requires stockholder approval; and *provided, further*, that awards will be governed by the version of the 2015 Plan then in effect at the time such award was granted. Unless earlier terminated, the 2015 Plan will terminate ten years from the date it was adopted by the Board, that is on November 17, 2025.

Stock Options. The 2015 Plan provides for the grant of nonqualified stock options as well as incentive stock options, which qualify under Section 422 of the Internal Revenue Code and may be granted only to our employees or employees of any parent or subsidiary of ours. The grant date of an option is the date on which the Committee makes the determination to grant the option or a specified future date. The exercise price of incentive stock options and nonqualified stock options will not be less than 100% of the fair market value of our shares of common stock on the date of grant; *provided, however*, that the exercise price of incentive stock options granted to 10% stockholders must be at least equal to 110% of the fair market value of our shares of common stock on the date of grant. The maximum term of options granted under our 2015 Plan is ten years and the maximum term of incentive stock options granted to 10% stockholders is five years.

Except as may be set forth in an award agreement, vesting ceases upon termination, and the exercise of an option will be subject to the following:

- If the participant is terminated for any reason except for cause, death or disability, then the participant may exercise options to the extent that such options would have been exercisable on the termination date no later than three months following termination, but in any event no later than the expiration date of the options.
- If the participant is terminated due to death (or the participant dies within three months after a termination other than for cause or disability), then the participant's options may be exercised only to the extent that such options would have been exercisable on the termination date and must be exercised by the participant's legal representative, or authorized assignee, no later than twelve months after termination, but in any event no later than the expiration date of the options.
- If the participant is terminated due to disability, then the participant's options may be exercised only to the extent that such options would have been exercisable on the termination date and must be exercised by the participant (or legal representative or authorized assignee) no later than twelve months after termination date, but in any event no later than the expiration date of the options.
- If the participant is terminated for cause, the participant's options will expire upon termination.

Restricted Stock Awards. A restricted stock award is an offer by us to sell shares of our common stock subject to restrictions (which may be service and/or performance based). The price of a restricted stock award will be determined by the Committee and may be less than fair market value on the date of grant. Unless otherwise determined by the Committee, vesting ceases on the date the participant no longer provides service to us and unvested shares are forfeited.

Stock Bonus Awards. Stock bonus awards are granted as additional compensation for service and/or performance. The Committee will determine the number of shares to be awarded to the participant under a stock bonus award and any applicable restrictions. Except as may be set forth in the participant's award agreement, vesting ceases upon termination.

Stock Appreciation Rights. Stock appreciation rights provide for a payment, or payments, in cash or shares of common stock, to the participant based upon the difference between the fair market value of our common stock on the date of exercise over the stated exercise price up to a maximum amount of cash or number of shares. The exercise price of a SAR may not be less than the fair market value of our shares of common stock on the date of grant. Stock appreciation rights may vest based on time or achievement of performance conditions and have a maximum term of ten years.

Restricted Stock Units. A restricted stock unit is an award denominated in shares that may be settled in shares, cash, or a combination of shares and cash, upon vesting. Restricted stock units may be subject to service and/or performance based vesting conditions. Except as may be set forth in the participant's award agreement, vesting ceases upon termination.

Performance Awards. Performance awards include performance shares, performance units, and cash-based awards. Performance shares and units may be settled in shares, cash, or a combination of shares and cash. After the applicable performance period has ended, the holder of a performance award will be entitled to receive a payout of the number of shares or amount of cash earned over the performance period, to be determined as a function of the extent to which the corresponding performance factors or other vesting provisions have been achieved.

Non-Employee Director Awards. Awards granted to non-employee directors under the 2015 Plan may be automatically made pursuant to a policy adopted by the Board or made from time to time as determined in the discretion of the Board. A non-employee director may elect to receive his or her annual retainer payments and/or meeting fees from Shutterfly in the form of cash or awards or a combination thereof, as determined by the Committee. Such awards will be issued under the 2015 Plan.

Restrictions on Dividends and Dividend Equivalents. Notwithstanding anything to the contrary in the 2015 Plan, cash dividends, stock and any other property (other than cash) distributed as a dividend or otherwise with respect to any award that vests based on achievement of performance goals will either (i) not be paid or credited or (ii) be accumulated, and will be subject to restrictions and risk of forfeiture to the same extent as the underlying award and will be paid at the time such restrictions and risk of forfeiture lapse.

Effect of Corporate Transaction. In the event of a "corporate transaction" (as defined in the 2015 Plan), all shares acquired under the 2015 Plan and all awards will be subject to the agreement governing such corporate transaction. Such agreement need not treat all awards in an identical manner, and it will provide for one or more of the following with respect to each award: (i) the continuation of the award by Shutterfly (if Shutterfly is the surviving corporation); (ii) the assumption or substitution of the award by the surviving corporation or its parent; (iii) full or partial acceleration of exercisability or vesting and accelerated expiration of an outstanding award; (iv) payment to the participant equal to the excess of the fair market value of the shares subject to the award as of the effective date of such corporate transaction over the exercise price or purchase price of shares, which payment may be made in installments and may be deferred until the date or dates when the award would have become exercisable or such shares would have vested; and/or (v) the cancellation of outstanding awards in exchange for no consideration. In the event such successor or acquiring corporation refuses to assume, convert, replace or substitute awards, as provided above, the Committee will notify the participant that such award will be exercisable for a specified period of time, and such award will terminate upon the expiration of such period.

Foreign Award Recipients. In order to comply with the laws in other countries in which Shutterfly and its subsidiaries and affiliates operate or have employees or other individuals eligible for awards, the Committee will have the power and authority to modify the terms and conditions of any award granted to individuals outside the United States to comply with applicable foreign laws, establish subplans and modify exercise procedures and other terms and procedures, and take any action that the Committee determines to be necessary or advisable to comply with any local governmental regulatory exemptions or approvals.

U.S. FEDERAL INCOME TAX CONSEQUENCES

The following summary is intended only as a general guide to the U.S. federal income tax consequences of participation in the 2015 Plan and does not attempt to describe all possible federal or other tax consequences of such participation or tax consequences based on particular circumstances.

Incentive Stock Options. An optionee who is granted an incentive stock option does not recognize taxable income at the time the option is granted or upon its exercise, although the exercise may subject the optionee to the alternative minimum tax. Upon a disposition of the shares more than two years after grant of the option and one year after exercise of the option, any gain or loss is treated as long-term capital gain or loss. If these holding periods are not satisfied, the optionee recognizes ordinary income at the time of disposition equal to the difference between the exercise price and the lower of (i) the fair market value of the shares at the date of the option exercise or (ii) the sale price of the shares. Any gain or loss recognized on such a premature disposition of the shares to the extent not recognized as taxable income as provided above, is treated as long-term or short-term capital gain or loss, depending on the holding period.

Nonqualified Stock Options. An optionee does not recognize any taxable income at the time he or she is granted a nonqualified stock option. Upon exercise, the optionee recognizes taxable income generally measured by the excess of the then fair market value of the shares over the exercise price. Any taxable income recognized in connection with an option exercise by our employee is subject to tax withholding by us. We are generally entitled to a deduction in the same amount as the ordinary income recognized by the optionee. Upon a disposition of such shares by the optionee, any difference between the sale price and the optionee's exercise price, to the extent not recognized as taxable income as provided above, is treated as long-term or short-term capital gain or loss, depending on the holding period.

Restricted Stock. A participant acquiring restricted stock generally will recognize ordinary income equal to the fair market value of the shares on the date our right of repurchase lapses (i.e. the date the award vests). If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. The participant may elect, pursuant to Section 83(b) of the Code, to include in income the value of the shares on acquisition of the shares, provided such election is made no later than 30 days after the participant acquires the shares. Upon the sale of shares acquired pursuant to a restricted stock award pursuant to which an election pursuant to Section 83(b) of the Code has been made, any gain or loss, based on the difference between the sale price and the fair market value on the determination date, will be taxed as short term or long-term capital gain or loss, depending on the holding period. Any taxable income recognized in connection with the grant of restricted stock by our employee is subject to tax withholding by us. Shutterfly generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant.

Stock Appreciation Rights. No taxable income is reportable when a stock appreciation right is granted to a participant. Upon exercise, the participant will recognize ordinary income in an amount equal to the amount of cash received and the fair market value of the shares received, and if granted to an employee, tax withholding is generally due. Any additional gain or loss recognized upon any later disposition of the shares would be capital gain or loss, depending on the holding period. Shutterfly generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant.

Stock Bonuses. A participant generally will recognize ordinary income upon the grant of a stock bonus equal to the fair market value of our shares on the date of grant. Such ordinary income generally is subject to withholding by us. Shutterfly generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant.

Restricted Stock Units and Performance Shares. A participant generally will recognize no income upon the grant of a restricted stock unit or performance share. Upon the settlement and/or payment of such awards, participants normally will recognize ordinary income in the year of receipt in an amount equal to the cash received and the fair market value of any non-restricted shares received. If the participant is an employee, such ordinary income generally is subject to withholding taxes. If the participant receives shares of restricted stock, the participant generally will be taxed in the same manner as described above (see discussion under "Restricted Stock"). Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value will be taxed as capital gain or loss, depending on the holding period. Shutterfly generally should be entitled to a deduction equal to the amount of ordinary income recognized by the participant.

The foregoing is only a summary of the effect of federal income taxation upon award recipients and us with respect to the grant and exercise of options, restricted stock units, stock appreciation rights, and the grant of stock awards under the 2015 Plan. Reference should be made to the applicable provisions of the Internal Revenue Code. In addition, the summary does not purport to be complete, and does not discuss the tax consequences of the 2015 Plan participant's death or the provisions of the income tax laws of any municipality, state or foreign country in which the 2015 Plan participant may reside.

PLAN BENEFITS

The future grant of options and restricted stock units under the 2015 Plan to our CEO, our other Named Executive Officers, all current executive officers as a group and all current employees (excluding executive officers) as a group is not determinable in advance because these grants are subject to the discretion of the Committee. As discussed in "Director Compensation" above, each non-employee director of our Board will receive

an annual restricted stock unit grant valued at $225,000 face value as determined by the closing price on the date of the Annual Meeting. The Chairman of the Board will receive an additional annual restricted stock unit grant valued at $85,000 face value based on the closing price on the date of the Annual Meeting. The Chairman of the Audit Committee will receive an additional annual restricted stock unit grant valued at $35,000 face value based on the closing price on the date of the Annual Meeting. The Chairman of the Committee will receive an additional annual restricted stock unit grant valued at $20,000 face value based on the closing price on the date of the Annual Meeting.

EQUITY COMPENSATION PLAN INFORMATION

The following table provides certain information with respect to all of our equity compensation plans in effect as of December 31, 2018.

PLAN CATEGORY	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, AWARDS, WARRANTS AND RIGHTS(A)	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, AWARDS, WARRANTS AND RIGHTS(B)	NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE UNDER EQUITY COMPENSATION PLANS (EXCLUDING SECURITIES REFLECTED IN COLUMN(A))(C)
Equity Compensation Plans Approved by Stockholders (1)(2)	2,455,635	$16.33(3)	1,765,905
Equity Compensation Plans Not Approved by Stockholders (4)	888,707	39.35(5)	—
Total	**3,344,342**	**—**	**1,765,905**

(1) Includes the 1999 Stock Plan, which was terminated in connection with our initial public offering, the 2006 Stock Plan (the "2006 Plan") which became effective as of the date of our initial public offering, and the 2015 Equity Incentive Plan (the "2015 Plan") which became effective on December 30, 2015. The 2006 Plan was terminated upon stockholder approval of the 2015 Plan at the special meeting of stockholders held in December 2015 (the "Special Meeting").

(2) The 2006 Plan previously contained an "evergreen" provision that was approved by our stockholders at the 2010 annual meeting of stockholders, pursuant to which the number of shares of Common Stock reserved for issuance under the 2006 Plan was increased on each of January 1, 2011, 2012 and 2013 by 3.5%, 3.3%, and 3.1%, respectively, of the number of shares of our Common Stock issued and outstanding as of the immediately preceding December 31, provided that no more than 7,000,000 shares of Common Stock be issued pursuant to the exercise of incentive stock options granted under the 2006 Plan. Additionally, at the 2013 annual meeting of stockholders, our stockholders approved of increasing the number of shares of Common Stock reserved for issuance under the 2006 Plan by 1,200,000 shares on each of January 1, 2014 and 2015. At the Special Meeting, our stockholders approved the 2015 Plan, authorizing 1,400,000 new shares of Common Stock for grants to service providers. At our annual meeting of stockholders on May 24, 2017, our stockholders approved of increasing the number of shares of Common Stock reserved for issuance under the 2015 Plan, by 1,300,000 shares and at our annual meeting of stockholders on May 23, 2018, our stockholders approved of increasing the number of shares of Common Stock reserved for issuance under the 2015 Plan by 900,000 shares.

(3) The weighted-average exercise price takes into account 1,777,274 shares of Common Stock under stockholder approved plans issuable upon vesting of outstanding restricted stock units ("RSUs"), which have no exercise price. The weighted-average exercise price for options only with respect to the stockholder approved plans is $59.13.

(4) Includes 46,462 shares of our common stock subject to stock options outstanding under inducement stock option grant and 36,120 shares outstanding under inducement RSUs grant to Ms. Anderson in 2017; 680,000 shares of our common stock subject to stock options outstanding under inducement stock option grant and 60,000 shares outstanding under inducement RSUs grant to Mr. North in 2016, 35,000 shares outstanding under inducement RSUs grants to Mr. Pope in 2015; 21,750 shares outstanding under inducement RSUs grants to Ms.Layney in 2015; and 9,375 shares outstanding under inducement RSU grants to certain employees of an acquired company (Mobixon) received on the date of the acquisition in 2015. All of these grants were made outside of a stockholder approved plan, pursuant to the exemption for inducement grants under the listing rules of the Nasdaq Stock Market and have the same material terms as the RSUs granted under our 2015 Plan and our prior 2006 Plan.

(5) The weighted-average exercise price takes into account 162,245 shares of Common Stock under non-stockholder approved plans issuable upon vesting of outstanding RSUs, which have no exercise price. The weighted-average exercise price for options only with respect to the non-stockholder approved plans is $48.13.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT STOCKHOLDERS VOTE "FOR" THE AMENDMENT OF OUR 2015 EQUITY INCENTIVE PLAN.

PROPOSAL NO. 4 RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has engaged PricewaterhouseCoopers LLP as our independent registered public accounting firm for the year ending December 31, 2019 and is seeking ratification of such selection by our stockholders at the Annual Meeting. PricewaterhouseCoopers LLP has audited our financial statements since 2001. Representatives of PricewaterhouseCoopers LLP are expected to be present at the Annual Meeting. They will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Neither our Bylaws nor other governing documents or law requires stockholder ratification of the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm. However, the Audit Committee is submitting the selection of PricewaterhouseCoopers LLP to our stockholders for ratification as a matter of good corporate practice. If our stockholders fail to ratify the selection, the Audit Committee will reconsider whether to retain PricewaterhouseCoopers LLP. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if they determine that such a change would be in the best interests of Shutterfly and our stockholders.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table provides information regarding the fees by PricewaterhouseCoopers LLP during the years ended December 31, 2018 and 2017. All fees described below were approved by the Audit Committee.

	YEAR ENDED DECEMBER 31,	
	2018	**2017**
Audit Fees	$ 5,086,000	$ 2,310,300
Audit-Related Fees	—	—
Tax Fees	—	—
All Other Fees	428,361	233,939
Total Fees	**$5,514,361**	**$2,544,239**

AUDIT FEES

Audit fees of PricewaterhouseCoopers LLP during 2018 and 2017 include the aggregate fees incurred for the audits of our annual consolidated financial statements and the reviews of each of the quarterly consolidated financial statements included in our Quarterly Reports on Form 10-Q.

The audit fees also included the audit of the effectiveness of our internal controls pursuant to Section 404 of the Sarbanes-Oxley Act. Audit fees in 2018 increased in comparison to 2017 due to the acquisition of Lifetouch on April 2, 2018.

AUDIT-RELATED FEES

Audit-related fees primarily consist of due diligence services to support our periodic mergers and acquisitions activities.

TAX FEES

Tax fees include the aggregate fees billed for services rendered for tax compliance, research and development, tax advice, and tax planning.

ALL OTHER FEES

Other fees include the aggregate fees for compliance-related services and access to online accounting and tax research software applications.

PRE-APPROVAL POLICIES AND PROCEDURES

The Audit Committee pre-approves all audit and non-audit services provided by its independent registered public accounting firm. This policy is set forth in the charter of the Audit Committee and available at *http://ir.shutterfly.com/essential-governance-documents* .

The Audit Committee considered whether the non-audit services rendered by PricewaterhouseCoopers LLP were compatible with maintaining PricewaterhouseCoopers LLP's independence as the independent registered public accounting firm of our consolidated financial statements and concluded they were.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE "FOR" THE RATIFICATION OF THE SELECTION OF PRICEWATERHOUSECOOPERS LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2019.

REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The material in this report is not "soliciting material," is not deemed "filed" with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Shutterfly under the Securities Act of 1933, as amended, or the Securities Exchange Act.

The primary purpose of the Audit Committee is to oversee our financial reporting processes on behalf of our Board of Directors. The Audit Committee's functions are more fully described in its charter, which is available on our website at http://ir.shutterfly.com/essential-governance-documents. Management has the primary responsibility for our financial statements and reporting processes, including our systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed and discussed with management our audited financial statements as of and for the year ended December 31, 2018.

The Audit Committee reviewed with PricewaterhouseCoopers LLP such matters as are required to be discussed with the Audit Committee under generally accepted auditing standards, including the matters required to be discussed by Auditing Standard No. 1301, "Communications with Audit Committees" issued by the Public Company Accounting Oversight Board ("PCAOB"). In addition, the Audit Committee discussed with PricewaterhouseCoopers LLP their independence, and received from PricewaterhouseCoopers LLP the written disclosures and the letter required by Ethics and Independence Rule 3526 of the PCAOB. Finally, the Audit Committee discussed with PricewaterhouseCoopers LLP, with and without management present, the scope and results of PricewaterhouseCoopers LLP's audit of such financial statements.

Based on these reviews and discussions, the Audit Committee has recommended to our Board of Directors that such audited financial statements be included in our Annual Report on Form 10-K for the year ended December 31, 2018 for filing with the Securities and Exchange Commission. The Audit Committee also has engaged PricewaterhouseCoopers LLP as our independent registered public accounting firm for the year ending December 31, 2019 and is seeking ratification of such selection by the stockholders.

Audit Committee

Elizabeth S. Rafael, Chair
H. Tayloe Stansbury
Brian T. Swette

CERTAIN TRANSACTIONS

From January 1, 2018 to the present, there have been no (and there are no currently proposed) transactions in which the amount involved exceeded $120,000 to which the Company was (or is to be) a party and in which any executive officer, director, 5% beneficial owner of our Common Stock or member of the immediate family of any of the foregoing persons had (or will have) a direct or indirect material interest.

Our Audit Committee reviews the fairness and approval of any proposed transaction between management and other related parties of the Company (other than transactions that are subject to review by the Committee) that are brought to the attention of the Audit Committee. In addition, our Code of Conduct and Ethics sets forth factors that should be considered in determining whether there may be a direct or indirect material interest, such as the size and nature of the person's interest, the nature of the Company's relationship with the other entity, whether the person has access to our confidential information, and whether the person has an ability to influence our decisions that would affect the other entity.

OTHER MATTERS

Our Board of Directors knows of no other matters that will be presented for consideration at the Annual Meeting. If any other matters are properly brought before the Annual Meeting, it is the intention of the persons named in the accompanying proxy to vote on such matters in accordance with their best judgment.

ANNUAL REPORT

Our 2018 Annual Report to Stockholders is part of the proxy materials being distributed to our stockholders in connection with the Annual Meeting. This Proxy Statement and our 2018 Annual Report can be accessed at http://ir.shutterfly.com/annual- reports-and-proxies which does not have "cookies" that identify visitors to the site. The 2018 Annual Report contains our consolidated financial statements for fiscal 2018.

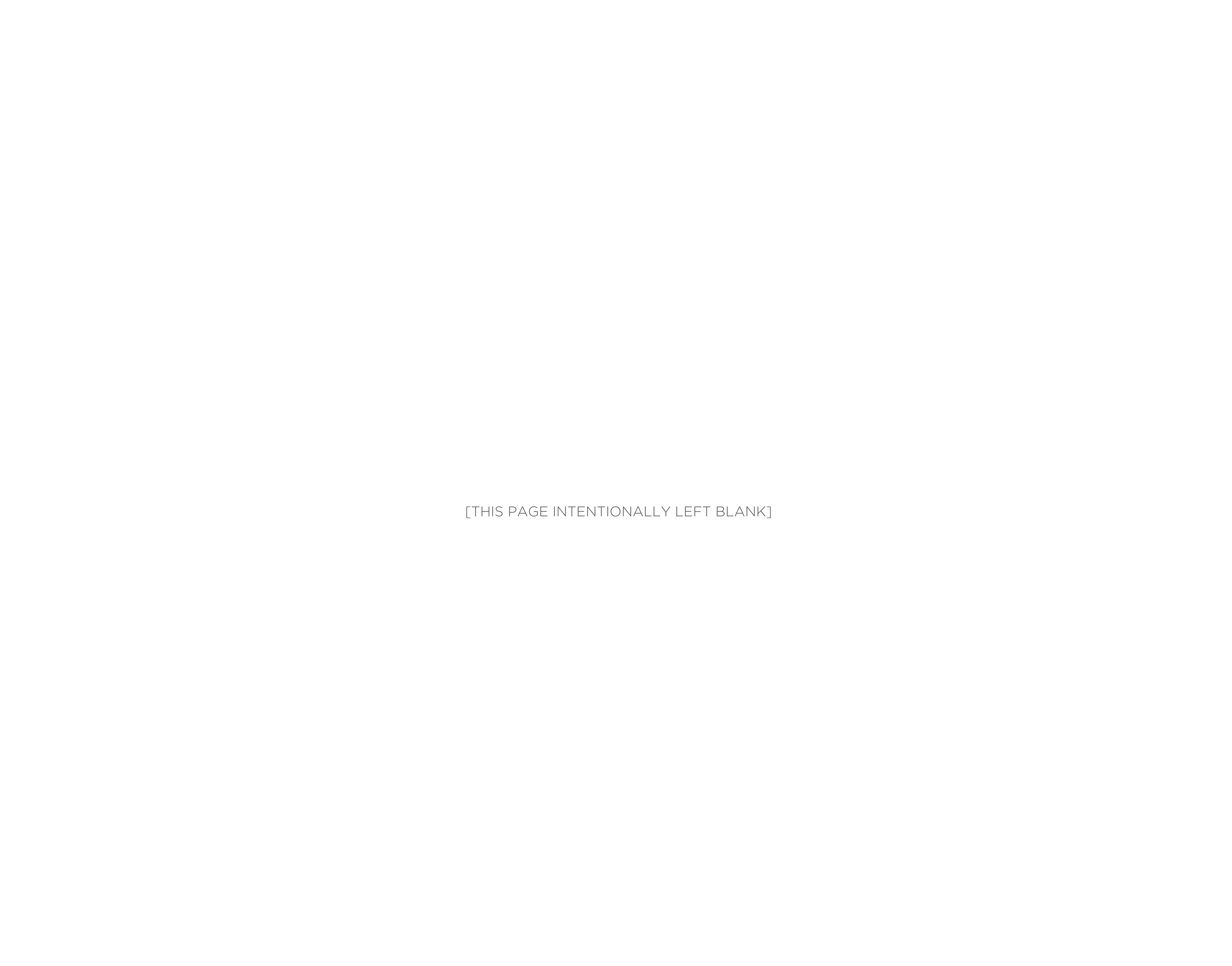
ANNUAL REPORT ON FORM 10-K

We have filed our Annual Report on Form 10-K for fiscal 2018 with the Securities and Exchange Commission. It is available free of charge at the Securities and Exchange Commission's website at www.sec.gov and also available on the "Investor Relations" section of our website at *ir.shutterfly.com/annual-reports-and-proxies*. Upon written request (analystinquiries@shutterfly.com) or telephone request (650-632-2310) by a Shutterfly stockholder, we will mail without charge a copy of our Annual Report on Form 10-K for fiscal 2018, including the financial statements and financial statement schedules, but excluding exhibits to the Annual Report on Form 10-K for fiscal 2018. Exhibits to the Annual Report on Form 10-K for fiscal 2018 are available upon payment of a reasonable fee, which is limited to our expenses in furnishing the requested exhibit(s). All requests should be directed to Investor Relations, Shutterfly, Inc., 2800 Bridge Parkway, Redwood City, California 94065.

By Order of the Board of Directors

Christopher North
President and Chief Executive Officer

Redwood City, California
April 5, 2019


[THIS PAGE INTENTIONALLY LEFT BLANK]

APPENDIX A

SHUTTERFLY, INC.
2015 EQUITY INCENTIVE PLAN

(adopted by the Board on November 17, 2015)
(amended and restated through April 2, 2019)

1. PURPOSE. The purpose of this Plan is to provide incentives to attract, retain and motivate eligible persons whose present and potential contributions are important to the success of the Company, and any Parents, Subsidiaries and Affiliates that exist now or in the future, by offering them an opportunity to participate in the Company's future performance through the grant of Awards. Capitalized terms not defined elsewhere in the text are defined in Section 27.

2. SHARES SUBJECT TO THE PLAN.

2.1 Number of Shares Available. Subject to Sections 2.4 and 21 and any other applicable provisions hereof, the total number of Shares reserved and available for grant and issuance pursuant to this Plan is 4,600,000 Shares, plus (i) any reserved shares not issued or subject to outstanding grants under the Company's 2006 Equity Incentive Plan (the "Prior Plan") on the Effective Date (as defined below), (ii) shares that are subject to options or other awards granted under the Prior Plan that cease to be subject to Awards by forfeiture or otherwise after the Effective Date for any reason; (iii) shares issued under the Prior Plan before or after the Effective Date pursuant to the exercise of options or stock appreciation rights that are, after the Effective Date, forfeited, (iv) shares issued under the Prior Plan that are repurchased by the Company at the original issue price; and (v) shares that are subject to options or other awards granted under the Prior Plan that otherwise terminate without Shares being issued. Awards issued as an Option or a SAR shall reduce the number of Shares available for issuance by the number of Shares underlying the Award, regardless of the number of Shares actually issued upon exercise of the Award. The Company may issue Shares that are authorized but unissued shares pursuant to the Awards granted under the Plan. The Company will reserve and keep available a sufficient number of Shares to satisfy the requirements of all outstanding Awards granted under the Plan.

2.2 Lapsed, Returned Awards. Shares subject to Awards, and Shares issued under the Plan under any Award, will again be available for grant and issuance in connection with subsequent Awards under this Plan to the extent such Shares: (a) are subject to issuance upon exercise of an Option or SAR granted under this Plan but which cease to be subject to the Option or SAR for any reason other than exercise of the Option or SAR; (b) are subject to Awards granted under this Plan that are forfeited or are repurchased by the Company at the original issue price; or (c) are subject to Awards granted under this Plan that otherwise terminate without such Shares being issued. The following Shares may not again be made available for future grant and issuance as Awards under the Plan: (i) Shares that are withheld to pay the exercise or purchase price of an Award or to satisfy any tax withholding obligations in connection with an Option or SAR, (ii) Shares not issued or delivered as a result of the net settlement of an outstanding Option or SAR or (iii) shares of the Company's Common Stock repurchased on the open market with the proceeds of an Option exercise price. To the extent that a Performance Award in the form of a cash bonus has been made, such Award will not reduce the number of Shares available for issuance under the Plan. For the avoidance of doubt, Shares that otherwise become available for grant and issuance because of the provisions of this Section 2.2 shall not include Shares subject to Awards that initially became available because of the substitution clause in Section 21.2 hereof.

2.3 Limitations. No more than 4,600,000 Shares shall be issued pursuant to the exercise of ISOs.

2.4 Adjustment of Shares. If the number of outstanding Shares is changed by a stock

dividend, recapitalization, stock split, reverse stock split, subdivision, combination, reclassification or similar change in the capital structure of the Company, without consideration, then (a) the number of Shares reserved for issuance and future grant under the Plan set forth in Sections 2.1 or 2.2, (b) the Exercise Prices of and number of Shares subject to outstanding Options and SARs, (c) the number of Shares subject to other outstanding Awards, (d) the maximum number of shares that may be issued as ISOs set forth in Section 2.3, and (e) the maximum number of Shares that may be issued to an individual or to a new Employee in any one calendar year set forth in Section 3, shall be proportionately adjusted, subject to any required action by the Board or the stockholders of the Company and in compliance with applicable securities laws; provided that fractions of a Share will not be issued.

3. ELIGIBILITY. ISOs may be granted only to Employees. All other Awards may be granted to Employees, Consultants, Directors and Non-Employee Directors; provided such Consultants, Directors and Non-Employee Directors render bona fide services not in connection with the offer and sale of securities in a capital-raising transaction. No Participant will be eligible for the grant of more than one million (1,000,000) Shares in any calendar year under this Plan pursuant to the grant of Awards.

4. ADMINISTRATION.

4.1 Committee Composition; Authority. This Plan will be administered by the Committee or by the Board acting as the Committee. Subject to the general purposes, terms and conditions of this Plan, and to the direction of the Board, the Committee will have full power to implement and carry out this Plan, except, however, the Board shall establish the terms for the grant of an Award to Non-Employee Directors. The Committee will have the authority to:

(a) construe and interpret this Plan, any Award Agreement and any other agreement or document executed pursuant to this Plan;

(b) prescribe, amend and rescind rules and regulations relating to this Plan or any Award;

(c) select persons to receive Awards;

(d) determine the form, terms and conditions, not inconsistent with the terms of the Plan, of any Award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Awards may vest and be exercised (which may be based on performance criteria) or settled, any vesting acceleration or waiver of forfeiture restrictions, the method to satisfy tax withholding obligations or any other tax or similar liability legally due and any restriction or limitation regarding any Award or the Shares relating thereto, based in each case on such factors as the Committee will determine;

(e) determine the number of Shares or other consideration subject to Awards;

(f) determine the Fair Market Value in good faith and interpret the applicable provisions of this Plan and the definition of Fair Market Value in connection with circumstances that impact the Fair Market Value, if necessary;

(g) determine whether Awards will be granted singly, in combination with, in tandem with, in replacement of, or as alternatives to, other Awards under this Plan or any other incentive or compensation plan of the Company or any Parent or Subsidiary of the Company;

(h) grant waivers of Plan or Award conditions;

(i) determine the vesting, exercisability and payment of Awards;

(j) correct any defect, supply any omission or reconcile any inconsistency in this Plan, any Award or any Award Agreement;

(k) determine whether an Award has been earned;

(l) reduce or waive any criteria with respect to Performance Factors;

(m) adjust Performance Factors to take into account changes in law and accounting or tax rules as the Committee deems necessary or appropriate to reflect the impact of extraordinary or unusual items, events or circumstances to avoid windfalls or hardships;

(n) Adopt rules and/or procedures (including the adoption of any subplan under this Plan) relating to the operation and administration of the Plan to accommodate requirements of local law and procedures outside of the United States;

(o) make all other determinations necessary or advisable for the administration of this Plan;

(p) delegate any of the foregoing to a subcommittee consisting of one or more executive officers pursuant to a specific delegation as permitted by applicable law, including Section 157(c) of the Delaware General Corporation Law, in which case references to "Committee" in this Section 4.1 will refer to such delegate(s), except with respect to Insiders; and

(q) to exercise negative discretion on Performance Awards, reducing or eliminating the amount to be paid to Participants.

4.2 Committee Interpretation and Discretion. Any determination made by the Committee with respect to any Award shall be made in its sole discretion at the time of grant of the Award or, unless in contravention of any express term of the Plan or Award, at any later time, and such determination shall be final and binding on the Company and all persons having an interest in any Award under the Plan. Any dispute regarding the interpretation of the Plan or any Award Agreement shall be submitted by the Participant or the Company to the Committee for review. The resolution of such a dispute by the Committee shall be final and binding on the Company and the Participant. The Committee may delegate to one or more executive officers the authority to review and resolve disputes with respect to Awards held by Participants who are not Insiders, and such resolution shall be final and binding on the Company and the Participant.

4.3 Omitted.

4.4 Documentation. The Award Agreement for a given Award, the Plan and any other documents may be delivered to, and accepted by, a Participant or any other person in any manner (including electronic distribution or posting) that meets applicable legal requirements.

4.5 Foreign Award Recipients. Notwithstanding any provision of the Plan to the contrary, in order to comply with the laws in other countries in which the Company and its Subsidiaries and Affiliates operate or have employees or other individuals eligible for Awards, the Committee, in its sole discretion, shall have the power and authority to: (a) determine which Subsidiaries and Affiliates shall be covered by the Plan; (b) determine which individuals outside the United States are eligible to participate in the Plan; (c) modify the terms and conditions of any Award granted to individuals outside the United States to comply with applicable foreign laws; (d) establish subplans and modify exercise procedures and other terms and procedures, to the extent the Committee determines such actions to be necessary or advisable (and such subplans and/or modifications shall be attached to this Plan as appendices); *provided, however*, that no such subplans and/ or modifications shall increase the share limitations contained in Section 2.1 hereof; and (e) take any action, before or after an Award is made, that the Committee determines to be necessary or advisable to obtain approval or comply with any local governmental regulatory exemptions or approvals. Notwithstanding the foregoing, the Committee may not take any actions hereunder, and no Awards shall be granted, that would violate the Exchange Act or any other applicable United States securities law, the Code, or any other applicable United States governing statute or law.

5. OPTIONS. An Option is the right but not the obligation to purchase a Share, subject to certain conditions, if applicable. The Committee may grant Options to eligible Employees, Consultants and Directors and will determine whether such Options will be Incentive Stock Options within the meaning of the Code ("ISOs") or Nonqualified Stock Options ("NQSOs"), the number of Shares subject to the Option, the Exercise Price of the Option, the period during which the Option may vest and be exercised, and all other terms and conditions of the Option, subject to the following:

5.1 Option Grant. Each Option granted under this Plan will identify the Option as an ISO or an NQSO. An Option may be, but need not be, awarded upon satisfaction of such Performance Factors during any Performance Period as are set out in advance in the Participant's individual Award Agreement. If the Option is being earned upon the satisfaction of Performance Factors, then the Committee will: (x) determine the nature, length and starting date of any Performance Period for each Option; and (y) select from among the Performance Factors to be used to measure the performance, if any. Performance Periods may overlap and Participants may participate simultaneously with respect to Options that are subject to different performance goals and other criteria.

5.2 Date of Grant. The date of grant of an Option will be the date on which the Committee makes the determination to grant such Option, or a specified future date. The Award Agreement will be delivered to the Participant within a reasonable time after the granting of the Option.

5.3 Exercise Period. Options may be vested and exercisable within the times or upon the conditions as set forth in the Award Agreement governing such Option; *provided, however*, that no Option will be exercisable after the expiration of ten (10) years from the date the Option is granted; and provided further that no ISO granted to a person who, at the time the ISO is granted, directly or by attribution owns more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or of any

Parent or Subsidiary (“Ten Percent Stockholder”) will be exercisable after the expiration of five (5) years from the date the ISO is granted. The Committee also may provide for Options to become exercisable at one time or from time to time, periodically or otherwise, in such number of Shares or percentage of Shares as the Committee determines.

5.4 Exercise Price. The Exercise Price of an Option will be determined by the Committee when the Option is granted; provided that: (i) the Exercise Price of an Option will be not less than one hundred percent (100%) of the Fair Market Value of the Shares on the date of grant and (ii) the Exercise Price of any ISO granted to a Ten Percent Stockholder will not be less than one hundred ten percent (110%) of the Fair Market Value of the Shares on the date of grant. Payment for the Shares purchased may be made in accordance with Section 11 and the Award Agreement and in accordance with any procedures established by the Company.

5.5 Method of Exercise. Any Option granted hereunder will be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Committee and set forth in the Award Agreement. An Option may not be exercised for a fraction of a Share. An Option will be deemed exercised when the Company receives: (i) notice of exercise (in such form as the Committee may specify from time to time) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised (together with applicable withholding taxes). Full payment may consist of any consideration and method of payment authorized by the Committee and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option will be issued in the name of the Participant. Until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder will exist with respect to the Shares, notwithstanding the exercise of the Option. The Company will issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 2.4 of the Plan. Exercising an Option in any manner will decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

5.6 Termination of Participant. Except as may be set forth in the Participant’s Award Agreement, vesting ceases on such Participant’s Termination Date (unless determined otherwise by the Committee). The exercise of an Option will be subject to the following (except as may be otherwise provided in an Award Agreement):

(a) If the Participant is Terminated for any reason except for Cause or the Participant’s death or Disability, then the Participant may exercise such Participant’s Options only to the extent that such Options would have been exercisable by the Participant on the Termination Date no later than three (3) months after the Termination Date (or such shorter time period or longer time period as may be determined by the Committee, with any exercise beyond three (3) months after the Termination Date deemed to be the exercise of an NQSO), but in any event no later than the expiration date of the Options.

(b) If the Participant is Terminated because of the Participant’s death (or the Participant dies within three (3) months after a Termination other than for Cause or because of the Participant’s Disability), then the Participant’s Options may be exercised only to the extent that such Options would have been exercisable by the Participant on the Termination Date and must be exercised by the Participant’s legal representative, or authorized assignee, no later than twelve (12) months after the Termination Date (or such shorter time period not less than six (6) months or longer time period as may be determined by the Committee), but in any event no later than the expiration date of the Options.

(c) If the Participant is Terminated because of the Participant’s Disability, then the Participant’s Options may be exercised only to the extent that such Options would have been exercisable by the Participant on the Termination Date and must be exercised by the Participant (or the Participant’s legal representative or authorized assignee) no later than twelve (12) months after the Termination Date (with any exercise beyond (a) three (3) months after the Termination Date when the Termination is for a Disability that is not a “permanent and total disability” as defined in Section 22(e)(3) of the Code, or (b) twelve (12) months after the Termination Date when the Termination is for a Disability that is a “permanent and total disability” as defined in Section 22(e)(3) of the Code, deemed to be exercise of an NQSO), but in any event no later than the expiration date of the Options.

(d) If the Participant is terminated for Cause, then Participant's Options shall expire on such Participant's Termination Date, or at such later time and on such conditions as are determined by the Committee, but in any no event later than the expiration date of the Options. Unless otherwise provided in the Award Agreement, Cause will have the meaning set forth in the Plan.

5.7 Limitations on Exercise. The Committee may specify a minimum number of Shares that may be purchased on any exercise of an Option, provided that such minimum number will not prevent any Participant from exercising the Option for the full number of Shares for which it is then exercisable.

5.8 Limitations on ISOs. With respect to Awards granted as ISOs, to the extent that the aggregate Fair Market Value of the Shares with respect to which such ISOs are exercisable for the first time by the Participant during any calendar year (under all plans of the Company and any Parent or Subsidiary) exceeds one hundred thousand dollars ($100,000), such Options will be treated as NQSOs. For purposes of this Section 5.8, ISOs will be taken into account in the order in which they were granted. The Fair Market Value of the Shares will be determined as of the time the Option with respect to such Shares is granted. In the event that the Code or the regulations promulgated thereunder are amended after the Effective Date to provide for a different limit on the Fair Market Value of Shares permitted to be subject to ISOs, such different limit will be automatically incorporated herein and will apply to any Options granted after the effective date of such amendment.

5.9 Modification, Extension or Renewal. The Committee may modify, extend or renew outstanding Options and authorize the grant of new Options in substitution therefor, provided that any such action may not, without the written consent of a Participant, impair any of such Participant's rights under any Option previously granted. Any outstanding ISO that is modified, extended, renewed or otherwise altered will be treated in accordance with Section 424(h) of the Code. Subject to Section 18 of this Plan, by written notice to affected Participants, the Committee may reduce the Exercise Price of outstanding Options without the consent of such Participants; *provided, however*, that the Exercise Price may not be reduced below the Fair Market Value on the date the action is taken to reduce the Exercise Price.

5.10 No Disqualification. Notwithstanding any other provision in this Plan, no term of this Plan relating to ISOs will be interpreted, amended or altered, nor will any discretion or authority granted under this Plan be exercised, so as to disqualify this Plan under Section 422 of the Code or, without the consent of the Participant affected, to disqualify any ISO under Section 422 of the Code.

6. RESTRICTED STOCK AWARDS.

6.1 Awards of Restricted Stock. A Restricted Stock Award is an offer by the Company to sell to an eligible Employee, Consultant or Director Shares that are subject to restrictions ("Restricted Stock"). The Committee will determine to whom an offer will be made, the number of Shares the Participant may purchase, the Purchase Price, the restrictions under which the Shares will be subject and all other terms and conditions of the Restricted Stock Award, subject to the Plan.

6.2 Restricted Stock Purchase Agreement. All purchases under a Restricted Stock Award will be evidenced by an Award Agreement. Except as may otherwise be provided in an Award Agreement, a Participant accepts a Restricted Stock Award by signing and delivering to the Company an Award Agreement with full payment of the Purchase Price, within thirty (30) days from the date the Award Agreement was delivered to the Participant. If the Participant does not accept such Award within thirty (30) days, then the offer of such Restricted Stock Award will terminate, unless the Committee determines otherwise.

6.3 Purchase Price. The Purchase Price for a Restricted Stock Award will be determined by the Committee and may be less than Fair Market Value on the date the Restricted Stock Award is granted. Payment of the Purchase Price must be made in accordance with Section 11 of the Plan, and the Award Agreement, and in accordance with any procedures established by the Company.

6.4 Terms of Restricted Stock Awards. Restricted Stock Awards will be subject to such restrictions as the Committee may impose or are required by law. These restrictions may be based on completion of a specified number of years of service with the Company or upon completion of Performance Factors, if any, during any Performance Period as set out in advance in the Participant's Award Agreement. Prior to the grant of a Restricted Stock Award, the Committee shall: (a) determine the nature, length and starting date of any Performance Period for the Restricted Stock Award; (b) select from among the

Performance Factors to be used to measure performance goals, if any; and (c) determine the number of Shares that may be awarded to the Participant. Performance Periods may overlap and a Participant may participate simultaneously with respect to Restricted Stock Awards that are subject to different Performance Periods and having different performance goals and other criteria.

6.5 Termination of Participant. Except as may be set forth in the Participant's Award Agreement, vesting ceases on such Participant's Termination Date (unless determined otherwise by the Committee).

7. STOCK BONUS AWARDS.

7.1 Awards of Stock Bonuses. A Stock Bonus Award is an award to an eligible Employee, Consultant or Director of Shares for services to be rendered or for past services already rendered to the Company or any Parent, Subsidiary, or Affiliate. All Stock Bonus Awards shall be made pursuant to an Award Agreement. No payment from the Participant will be required for Shares awarded pursuant to a Stock Bonus Award.

7.2 Terms of Stock Bonus Awards. The Committee will determine the number of Shares to be awarded to the Participant under a Stock Bonus Award and any restrictions thereon. These restrictions may be based upon completion of a specified number of years of service with the Company or upon satisfaction of performance goals based on Performance Factors during any Performance Period as set out in advance in the Participant's Stock Bonus Agreement. Prior to the grant of any Stock Bonus Award the Committee shall: (a) determine the nature, length and starting date of any Performance Period for the Stock Bonus Award; (b) select from among the Performance Factors to be used to measure performance goals; and (c) determine the number of Shares that may be awarded to the Participant. Performance Periods may overlap and a Participant may participate simultaneously with respect to Stock Bonus Awards that are subject to different Performance Periods and different performance goals and other criteria.

7.3 Form of Payment to Participant. Payment may be made in the form of cash, whole Shares, or a combination thereof, based on the Fair Market Value of the Shares earned under a Stock Bonus Award on the date of payment, as determined in the sole discretion of the Committee.

7.4 Termination of Service. Except as may be set forth in the Participant's Award Agreement, vesting ceases on such Participant's Termination Date (unless determined otherwise by the Committee).

8. STOCK APPRECIATION RIGHTS.

8.1 Awards of SARs. A Stock Appreciation Right ("SAR") is an award to an eligible Employee, Consultant or Director that may be settled in cash or Shares (which may consist of Restricted Stock), having a value equal to (a) the difference between the Fair Market Value on the date of exercise over the Exercise Price multiplied by (b) the number of Shares with respect to which the SAR is being settled (subject to any maximum number of Shares that may be issuable as specified in an Award Agreement). All SARs shall be made pursuant to an Award Agreement.

8.2 Terms of SARs. The Committee will determine the terms of each SAR including, without limitation: (a) the number of Shares subject to the SAR; (b) the Exercise Price and the time or times during which the SAR may be settled; (c) the consideration to be distributed on settlement of the SAR; and (d) the effect of the Participant's Termination on each SAR. The Exercise Price of the SAR will be determined by the Committee when the SAR is granted, and may not be less than Fair Market Value. A SAR may be awarded upon satisfaction of Performance Factors, if any, during any Performance Period as are set out in advance in the Participant's individual Award Agreement. If the SAR is being earned upon the satisfaction of Performance Factors, then the Committee will: (x) determine the nature, length and starting date of any Performance Period for each SAR; and (y) select from among the Performance Factors to be used to measure the performance, if any. Performance Periods may overlap and Participants may participate simultaneously with respect to SARs that are subject to different Performance Factors and other criteria.

8.3 Exercise Period and Expiration Date. A SAR will be exercisable within the times or upon the occurrence of events determined by the Committee and set forth in the Award Agreement governing such SAR. The SAR Agreement shall set forth the expiration date; provided that no SAR will be exercisable after the expiration of ten (10) years from the date the SAR is granted. The Committee may also provide for SARs to become exercisable at one time or from time to time, periodically or otherwise (including, without limitation, upon the attainment during a Performance Period of performance goals based on Performance Factors), in such number of

Shares or percentage of the Shares subject to the SAR as the Committee determines. Except as may be set forth in the Participant's Award Agreement, vesting ceases on such Participant's Termination Date (unless determined otherwise by the Committee). Notwithstanding the foregoing, the rules of Section 5.6 also will apply to SARs.

8.4 Form of Settlement. Upon exercise of a SAR, a Participant will be entitled to receive payment from the Company in an amount determined by multiplying (i) the difference between the Fair Market Value of a Share on the date of exercise over the Exercise Price; times (ii) the number of Shares with respect to which the SAR is exercised. At the discretion of the Committee, the payment from the Company for the SAR exercise may be in cash, in Shares of equivalent value, or in some combination thereof. The portion of a SAR being settled may be paid currently or on a deferred basis with such interest or dividend equivalent, if any, as the Committee determines, provided that the terms of the SAR and any deferral satisfy the requirements of Section 409A of the Code.

9. RESTRICTED STOCK UNITS.

9.1 Awards of Restricted Stock Units. A Restricted Stock Unit ("RSU") is an award to an eligible Employee, Consultant or Director covering a number of Shares that may be settled in cash, or by issuance of those Shares (which may consist of Restricted Stock). All RSUs shall be made pursuant to an Award Agreement.

9.2 Terms of RSUs. The Committee will determine the terms of an RSU including, without limitation: (a) the number of Shares subject to the RSU; (b) the time or times during which the RSU may be settled; (c) the consideration to be distributed on settlement; and (d) the effect of the Participant's Termination on each RSU. An RSU may be awarded upon satisfaction of such performance goals based on Performance Factors during any Performance Period as are set out in advance in the Participant's Award Agreement. If the RSU is being earned upon satisfaction of Performance Factors, then the Committee will: (x) determine the nature, length and starting date of any Performance Period for the RSU; (y) select from among the Performance Factors to be used to measure the performance, if any; and (z) determine the number of Shares deemed subject to the RSU. Performance Periods may overlap and participants may participate simultaneously with respect to RSUs that are subject to different Performance Periods and different performance goals and other criteria.

9.3 Form and Timing of Settlement. Payment of earned RSUs shall be made as soon as practicable after the date(s) determined by the Committee and set forth in the Award Agreement. The Committee, in its sole discretion, may settle earned RSUs in cash, Shares, or a combination of both. The Committee may also permit a Participant to defer payment under a RSU to a date or dates after the RSU is earned provided that the terms of the RSU and any deferral satisfy the requirements of Section 409A of the Code.

9.4 Termination of Service. Except as may be set forth in the Participant's Award Agreement, vesting ceases on such Participant's Termination Date (unless determined otherwise by the Committee).

10. PERFORMANCE AWARDS. A Performance Award is an award to an eligible Employee, Consultant, or Director of a cash bonus or an award of Performance Shares denominated in Shares that may be settled in cash, or by issuance of those Shares (which may consist of Restricted Stock). Grants of Performance Awards shall be made pursuant to an Award Agreement that specifically references this Section 10.

10.1 Types of Performance Awards. Performance Awards shall include Performance Shares, Performance Units, and cash-based Awards as set forth in Sections 10.1(a), 10.1(b), and 10.1(c) below.

(a) Performance Shares. The Committee may grant Awards of Performance Shares, designate the Participants to whom Performance Shares are to be awarded and determine the number of Performance Shares and the terms and conditions of each such Award. Performance Shares shall consist of a unit valued by reference to a designated number of shares of Common Stock, the value of which may be paid to the Participant by delivery of shares of Common Stock or, if set forth in the instrument evidencing the Award, of such property as the Committee shall determine, including, without limitation, cash, shares of Common Stock, other property, or any combination thereof, upon the attainment of performance goals, as established by the Committee, and other terms and conditions specified by the Committee. The amount to be paid under an Award of Performance Shares may be adjusted on the basis of such further consideration as the Committee shall determine in its sole discretion.

(b) Performance Units. The Committee may grant Awards of Performance Units, designate the Participants to whom Performance Units are to be

awarded and determine the number of Performance Units and the terms and conditions of each such Award. Performance Units shall consist of a unit valued by reference to a designated amount of property other than shares of Common Stock, which value may be paid to the Participant by delivery of such property as the Committee shall determine, including, without limitation, cash, shares of Common Stock, other property, or any combination thereof, upon the attainment of performance goals, as established by the Committee, and other terms and conditions specified by the Committee.

(c) Cash-Settled Performance Awards. The Committee may also grant cash-settled Performance Awards to Participants under the terms of this Plan. Such awards will be based on the attainment of performance goals using the Performance Factors within this Plan that are established by the Committee for the relevant performance period.

10.2 Terms of Performance Awards. The Committee will determine, and each Award Agreement shall set forth, the terms of each Performance Award including, without limitation: (a) the amount of any cash bonus; (b) the number of Shares deemed subject to an award of Performance Shares (if any); (c) the Performance Factors and Performance Period that shall determine the time and extent to which each Performance Award will be settled; (d) the consideration to be distributed on settlement; and (e) the effect of the Participant's Termination on each Performance Award. In establishing Performance Factors and the Performance Period the Committee will: (x) determine the nature, length and starting date of any Performance Period; (y) select from among the Performance Factors to be used and (z) determine the number of Shares deemed subject to the Performance Award (if any). Prior to settlement the Committee shall determine the extent to which Performance Awards have been earned. Performance Periods may overlap and Participants may participate simultaneously with respect to Performance Awards that are subject to different Performance Periods and different performance goals and other criteria. No Participant will be eligible for the grant of more than ten million dollars ($10,000,000) in Performance Awards denominated in cash in any calendar year under this Plan.

10.3 Value, Earning and Timing of Performance Shares. Any Award of Performance Shares will have an initial value equal to the Fair Market Value of a Share on the date of grant. After the applicable Performance Period has ended, the holder of an Award of Performance Shares will be entitled to receive a payout of the number of Shares earned by the Participant over the Performance Period, to be determined as a function of the extent to which the corresponding Performance Factors or other vesting provisions have been achieved. The Committee, in its sole discretion, may pay an earned Performance Share Award in the form of cash, in Shares (which have an aggregate Fair Market Value equal to the value of the earned Performance Shares at the close of the applicable Performance Period) or in a combination thereof. Performance Shares may also be settled in Restricted Stock.

10.4 Termination of Participant. Except as may be set forth in the Participant's Award Agreement, vesting ceases on such Participant's Termination Date (unless determined otherwise by the Committee).

11. PAYMENT FOR SHARE PURCHASES. Payment from a Participant for Shares purchased pursuant to this Plan may be made in cash or by check or, where approved for the Participant by the Committee and where permitted by law (and to the extent not otherwise set forth in the applicable Award Agreement):

(a) by cancellation of indebtedness of the Company to the Participant;

(b) by surrender of shares of capital stock of the Company held by the Participant that have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Award will be exercised or settled;

(c) by waiver of compensation due or accrued to the Participant for services rendered or to be rendered to the Company or a Parent or Subsidiary of the Company;

(d) by consideration received by the Company pursuant to a broker-assisted or other form of cashless exercise program implemented by the Company in connection with the Plan;

(e) by any combination of the foregoing; or

(f) by any other method of payment as is permitted by applicable law.

12. GRANTS TO NON-EMPLOYEE DIRECTORS.

12.1 Types of Awards. Non-Employee Directors are eligible to receive any type of Award offered

under this Plan except ISOs. Awards pursuant to this Section 12 may be automatically made pursuant to policy adopted by the Board, or made from time to time as determined in the discretion of the Board. The aggregate cash and equity compensation granted to a Non-Employee Director pursuant to this Section 12 in any calendar year shall not exceed $750,000.

12.2 Eligibility. Awards pursuant to this Section 12 shall be granted only to Non-Employee Directors. A Non-Employee Director who is elected, re-elected or appointed as a member of the Board will be eligible to receive an Award under this Section 12.

12.3 Vesting, Exercisability and Settlement. Except as set forth in Section 21, Awards shall vest, become exercisable and be settled as determined by the Board. With respect to Options and SARs, the exercise price granted to Non-Employee Directors shall not be less than the Fair Market Value of the Shares at the time that such Option or SAR is granted.

12.4 Election to receive Awards in Lieu of Cash. A Non-Employee Director may elect to receive his or her annual retainer payments and/or meeting fees from the Company in the form of cash or Awards or a combination thereof, as determined by the Committee. Such Awards shall be issued under the Plan. An election under this Section 12.4 shall be filed with the Company on the form prescribed by the Company.

13. WITHHOLDING TAXES.

13.1 Withholding Generally. Whenever Shares are to be issued in satisfaction of Awards granted under this Plan or a tax event occurs, the Company may require the Participant to remit to the Company, or to the Parent, Subsidiary or applicable Affiliate employing the Participant, an amount sufficient to satisfy applicable U.S. federal, state, local and international withholding tax requirements or any other tax or social insurance liability legally due from the Participant prior to the delivery of Shares pursuant to exercise or settlement of any Award. Whenever payments in satisfaction of Awards granted under this Plan are to be made in cash, such payment will be net of an amount sufficient to satisfy applicable U.S. federal, state, local and international withholding tax or social insurance requirements or any other tax liability legally due from the Participant. The Fair Market Value of the Shares will be determined as of the date that the taxes are required to be withheld and such Shares shall be valued based on the value of the actual trade or, if there is none, the Fair Market Value of the Shares as of the previous trading day.

13.2 Stock Withholding. The Committee, as permitted by applicable law, in its sole discretion and pursuant to such procedures as it may specify from time to time and to limitations of local law, may require or permit a Participant to satisfy such tax withholding obligation or any other tax liability legally due from the Participant, in whole or in part by (without limitation) (a) paying cash, (b) electing to have the Company withhold otherwise deliverable cash or Shares having a Fair Market Value equal to the minimum statutory amount required to be withheld or such greater amount that will not cause adverse accounting treatment for the Company or any Parent or Subsidiary, (c) delivering to the Company already-owned Shares having a Fair Market Value equal to the minimum statutory amount required to be withheld or such greater amount that will not cause adverse accounting treatment for the Company or any Parent or Subsidiary, or (d) withholding from proceeds of the sale of otherwise deliverable Shares acquired pursuant to an Award either through a voluntary sale or through a mandatory sale arranged by the Company for the minimum amount required to be withheld or such greater amount that will not cause adverse accounting treatment for the Company or any Parent or Subsidiary. The Fair Market Value of the Shares to be withheld or delivered will be determined as of the date that the taxes are required to be withheld.

14. TRANSFERABILITY. Unless determined otherwise by the Committee or its delegate(s) or pursuant to this Section 14, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner, other than by (i) a will or (ii) by the laws of descent or distribution. If the Committee makes an Award transferable, including, without limitation, by instrument to an inter vivos or testamentary trust in which the Awards are to be passed to beneficiaries upon the death of the trustor (settlor) or by gift or domestic relations order to a Permitted Transferee, such Award shall contain such additional terms and conditions as the Committee or its delegate(s) deems appropriate. All Awards will be exercisable: (A) during the Participant's lifetime only by (x) the Participant, or (y) the Participant's guardian or legal representative; (B) after the Participant's death, by the legal representative of the Participant's heirs or legatees; and (C) in the case of all awards except ISOs, by a Permitted Transferee (for

awards made transferable by the Committee) or such person's guardian or legal representative.

15. PRIVILEGES OF STOCK OWNERSHIP; RESTRICTIONS ON SHARES.

15.1 Voting and Dividends. No Participant will have any of the rights of a stockholder with respect to any Shares until the Shares are issued to the Participant, except for any dividend equivalent rights permitted by an applicable Award Agreement ("Dividend Equivalent Rights"). After Shares are issued to the Participant, the Participant will be a stockholder and have all the rights of a stockholder with respect to such Shares, including the right to vote and receive all dividends or other distributions made or paid with respect to such Shares; *provided*, that if such Shares are Restricted Stock, then any new, additional or different securities the Participant may become entitled to receive with respect to such Shares by virtue of a stock dividend, stock split or any other change in the corporate or capital structure of the Company will be subject to the same restrictions as the Restricted Stock; *provided, further*, that the Participant will have no right to retain such stock dividends or stock distributions with respect to Shares that are repurchased at the Participant's Purchase Price or Exercise Price, as the case may be, pursuant to Section 15.2. However, the Committee, in its discretion, may provide in the Award Agreement evidencing any Award that the Participant shall be entitled to Dividend Equivalent Rights with respect to the payment of cash dividends on Shares underlying an Award during the period beginning on the date the Award is granted and ending, with respect to each Share subject to the Award, on the earlier of the date on which the Award is exercised or settled or the date on which it is forfeited. Such Dividend Equivalent Rights, if any, shall be credited to the Participant in the form of additional whole Shares as of the date of payment of such cash dividends on Shares. Notwithstanding the provisions of this Section, cash dividends, stock and any other property (other than cash) distributed as a dividend or otherwise with respect to any Award that vests based on achievement of performance goals shall either (i) not be paid or credited or (ii) be accumulated, shall be subject to restrictions and risk of forfeiture to the same extent as the underlying Award and shall be paid at the time such restrictions and risk of forfeiture lapse.

15.2 Restrictions on Shares. At the discretion of the Committee, the Company may reserve to itself and/or its assignee(s) a right to repurchase (a "Right of Repurchase") a portion of any or all Unvested Shares held by a Participant following such Participant's Termination at any time within ninety (90) days (or such longer or shorter time determined by the Committee) after the later of the Participant's Termination Date and the date the Participant purchases Shares under this Plan, for cash and/or cancellation of purchase money indebtedness, at the Participant's Purchase Price or Exercise Price, as the case may be.

16. CERTIFICATES. All Shares or other securities, whether or not certificated, delivered under this Plan will be subject to such stock transfer orders, legends and other restrictions as the Committee may deem necessary or advisable, including restrictions under any applicable U.S. federal, state or foreign securities law, or any rules, regulations and other requirements of the SEC or any stock exchange or automated quotation system upon which the Shares may be listed or quoted and any non-U.S. exchange controls or securities law restrictions to which the Shares are subject.

17. ESCROW; PLEDGE OF SHARES. To enforce any restrictions on a Participant's Shares, the Committee may require the Participant to deposit all certificates representing Shares, together with stock powers or other instruments of transfer approved by the Committee, appropriately endorsed in blank, with the Company or an agent designated by the Company to hold in escrow until such restrictions have lapsed or terminated, and the Committee may cause a legend or legends referencing such restrictions to be placed on the certificates.

18. REPRICING; EXCHANGE AND BUYOUT OF AWARDS. Other than pursuant to Section 2.4, the Committee shall not without the approval of the Company's stockholders, (a) lower the exercise price per Share of an Option or SAR after it is granted, (b) cancel an Option or SAR when the exercise price per Share exceeds the Fair Market Value of one Share in exchange for cash or another Award (other than in connection with a Corporate Transaction pursuant to Section 21), or (c) take any other action with respect to an Option or SAR that would be treated as a repricing under the rules and regulations of the principal U.S. national securities exchange on which the Shares are listed.

19. SECURITIES LAW AND OTHER REGULATORY COMPLIANCE. An Award will not be effective unless such Award is in compliance with all applicable U.S. and foreign federal and state

securities and exchange control laws, rules and regulations of any governmental body, and the requirements of any stock exchange or automated quotation system upon which the Shares may then be listed or quoted, as they are in effect on the date of grant of the Award and also on the date of exercise or other issuance. Notwithstanding any other provision in this Plan, the Company will have no obligation to issue or deliver certificates for Shares under this Plan prior to: (a) obtaining any approvals from governmental agencies that the Company determines are necessary or advisable; and/ or (b) completion of any registration or other qualification of such Shares under any state or federal or foreign law or ruling of any governmental body that the Company determines to be necessary or advisable. The Company will be under no obligation to register the Shares with the SEC or to effect compliance with the registration, qualification or listing requirements of any foreign or state securities laws, exchange control laws, stock exchange or automated quotation system, and the Company will have no liability for any inability or failure to do so.

20. NO OBLIGATION TO EMPLOY. Nothing in this Plan or any Award granted under this Plan will confer or be deemed to confer on any Participant any right to continue in the employ of, or to continue any other relationship with, the Company or any Parent, Subsidiary or Affiliate or limit in any way the right of the Company or any Parent, Subsidiary or Affiliate to terminate Participant's employment or other relationship at any time.

21. CORPORATE TRANSACTIONS.

21.1 Assumption or Replacement of Awards by Successor. In the event of a Corporate Transaction, all Shares acquired under the Plan and all Awards will be subject to the agreement governing such Corporate Transaction. Such agreement need not treat all Awards in an identical manner, and it will provide for one or more of the following with respect to each Award:

(a) The continuation of the Award by the Company (if the Company is the surviving corporation).

(b) The assumption of the Award by the surviving corporation or its parent and, with respect to an Award that is subject to Section 409A of the Code, in a manner that complies with Section 424(a) of the Code (whether or not the Award is an ISO).

(c) The substitution by the surviving corporation or its parent of a new Award, and with respect an Award that is subject to Section 409A of the Code, in a manner that complies with Section 424(a) of the Code (whether or not the Award is an ISO).

(d) The full or partial acceleration of exercisability or vesting and accelerated expiration of an outstanding Award and lapse of the Company's right to repurchase or re-acquire shares acquired under an Award or lapse of forfeiture rights with respect to shares acquired under an Award.

(e) A payment to the Participant equal to the excess of (i) the Fair Market Value of the Shares subject to the Award as of the effective date of such Corporate Transaction over (ii) the Exercise Price or Purchase Price of Shares, as the case may be, subject to the Award in connection with the cancellation of the Award. Such payment will be made in the form of cash, cash equivalents, or securities of the surviving corporation or its parent with a Fair Market Value equal to the required amount. The successor corporation may provide substantially similar consideration to Participants as was provided to stockholders (after taking into account the existing provisions of the Awards). Subject to Section 409A of the Code, such payment may be made in installments and may be deferred until the date or dates when the Award would have become exercisable or such Shares would have vested. The amount of such payment initially will be calculated without regard to whether or not the Award is then exercisable or such Shares are then vested. However, such payment may be subject to vesting based on the Participant's continuing service as an Employee, Consultant or Director. In addition, any escrow, holdback, earnout or similar provisions in the agreement for such Corporate Transaction may apply to such payment to the same extent and in the same manner as such provisions apply to the holders of Shares. If the Exercise Price of the Shares subject to an Option exceeds the Fair Market Value of such Shares, then the Option may be cancelled without making a payment to the Participant. For purposes of this subsection, the Fair Market Value of any security will be determined without regard to any vesting conditions that may apply to such security.

(f) The cancellation of outstanding Awards in exchange for no consideration.

The Board shall have full power and authority to assign the Company's right to repurchase or re-acquire or forfeiture rights to such successor or

acquiring corporation. In addition, in the event such successor or acquiring corporation refuses to assume, convert, replace or substitute Awards, as provided above, pursuant to a Corporate Transaction, the Committee will notify the Participant in writing or electronically that such Award will be exercisable for a period of time determined by the Committee in its sole discretion, and such Award will terminate upon the expiration of such period. Awards need not be treated similarly in a Corporate Transaction.

21.2 Assumption of Awards by the Company. The Company, from time to time, also may substitute or assume outstanding awards granted by another company, whether in connection with an acquisition of such other company or otherwise, by either; (a) granting an Award under this Plan in substitution of such other company's award; or (b) assuming such award as if it had been granted under this Plan if the terms of such assumed award could be applied to an Award granted under this Plan. Such substitution or assumption will be permissible if the holder of the substituted or assumed award would have been eligible to be granted an Award under this Plan if the other company had applied the rules of this Plan to such grant. In the event the Company assumes an award granted by another company, the terms and conditions of such award will remain unchanged (except that the Purchase Price or the Exercise Price, as the case may be, and the number and nature of Shares issuable upon exercise or settlement of any such Award will be adjusted appropriately pursuant to Section 424(a) of the Code). In the event the Company elects to grant a new Option in substitution rather than assuming an existing option, such new Option may be granted with a similarly adjusted Exercise Price. Substitute Awards will not reduce the number of Shares authorized for grant under the Plan or authorized for grant to a Participant in any calendar year.

22. ADOPTION AND STOCKHOLDER APPROVAL. This Plan shall be submitted for the approval of the Company's stockholders, consistent with applicable laws, within twelve (12) months before or after the date this Plan is adopted by the Board.

23. TERM OF PLAN/GOVERNING LAW. Unless earlier terminated as provided herein, this Plan will become effective on the Effective Date and will terminate ten (10) years from the date this Plan is adopted by the Board. This Plan and all Awards granted hereunder shall be governed by and construed in accordance with the laws of the State of Delaware, without regard to its conflict of laws rules.

24. AMENDMENT OR TERMINATION OF PLAN. The Board may at any time terminate or amend this Plan in any respect, including, without limitation, amendment of any form of Award Agreement or instrument to be executed pursuant to this Plan; *provided, however*, that the Board will not, without the approval of the stockholders of the Company, amend this Plan in any manner that requires such stockholder approval; provided further, that a Participant's Award shall be governed by the version of this Plan then in effect at the time such Award was granted.

25. NONEXCLUSIVITY OF THE PLAN. Neither the adoption of this Plan by the Board, the submission of this Plan to the stockholders of the Company for approval, nor any provision of this Plan will be construed as creating any limitations on the power of the Board to adopt such additional compensation arrangements as it may deem desirable, including, without limitation, the granting of stock awards and bonuses otherwise than under this Plan, and such arrangements may be either generally applicable or applicable only in specific cases.

26. INSIDER TRADING POLICY; CLAWBACK OR RECOUPMENT POLICY. Each Participant who receives an Award shall comply with any policy adopted by the Company from time to time covering transactions in the Company's securities by Employees, officers and/or directors of the Company. All Awards shall be subject to clawback or recoupment pursuant to any compensation clawback or recoupment policy adopted by the Board or required by law during the term of Participant's employment or other service with the Company that is applicable to executive officers, employees, directors or other service providers of the Company, and in addition to any other remedies available under such policy and applicable law, may require the cancelation of outstanding Awards and the recoupment of any gains realized with respect to Awards.

27. DEFINITIONS. As used in this Plan, and except as elsewhere defined herein, the following terms will have the following meanings:

"Affiliate" means any person or entity that directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the Company, including any general partner, managing member, officer or director of the Company, in each case as

of the date on which, or at any time during the period for which, the determination of affiliation is being made. For purposes of this definition, the term "control" (including the correlative meanings of the terms "controlled by" and "under common control with"), as used with respect to any person or entity, means the possession, directly or indirectly, of the power to direct or cause the direction of the management policies of such person or entity, whether through the ownership of voting securities or by contract or otherwise.

"Award" means any award under the Plan, including any Option, Restricted Stock, Stock Bonus, Stock Appreciation Right, Restricted Stock Unit or Performance Award.

"**Award Agreement**" means, with respect to each Award, the written or electronic agreement between the Company and the Participant setting forth the terms and conditions of the Award, and country-specific appendix thereto for grants to non-U.S. Participants, which shall be in substantially a form (which need not be the same for each Participant) that the Committee (or in the case of Award Agreements that are not used by Insiders, the Committee's delegate(s)) has from time to time approved, and will comply with and be subject to the terms and conditions of this Plan.

"**Board**" means the Board of Directors of the Company.

"**Cause**" means (a) the commission of an act of theft, embezzlement, fraud, dishonesty, (b) a breach of fiduciary duty to the Company or a Parent or Subsidiary of the Company, or (c) a failure to materially perform the customary duties of employee's employment, unless other provided in an individual agreement with the Award recipient.

"**Code**" means the United States Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

"**Committee**" means the Compensation and Leadership Development Committee of the Board or those persons to whom administration of the Plan, or part of the Plan, has been delegated as permitted by law.

"**Common Stock**" means the common stock of the Company.

"**Company**" means Shutterfly, Inc., or any successor corporation.

"**Consultant**" means any person, including an advisor or independent contractor, engaged by the Company or a Parent, Subsidiary or Affiliate to render services to such entity.

"**Corporate Transaction**" means the occurrence of any of the following events: (a) any "Person" (as such term is used in Sections 13(d) and 14(d) of the Exchange Act) becomes the "beneficial owner" (as defined in Rule 13d-3 of the Exchange Act), directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the total voting power represented by the Company's then-outstanding voting securities; *provided, however*, that for purposes of this subclause (a) the acquisition of additional securities by any one Person who is considered to own more than fifty percent (50%) of the total voting power of the securities of the Company will not be considered a Corporate Transaction; (b) the consummation of the sale or disposition by the Company of all or substantially all of the Company's assets; (c) the consummation of a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or its parent) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity or its parent outstanding immediately after such merger or consolidation; (d) any other transaction which qualifies as a "corporate transaction" under Section 424(a) of the Code wherein the stockholders of the Company give up all of their equity interest in the Company (except for the acquisition, sale or transfer of all or substantially all of the outstanding shares of the Company) or (e) a change in the effective control of the Company that occurs on the date that a majority of members of the Board is replaced during any twelve (12) month period by members of the Board whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election. For purpose of this subclause (e), if any Person is considered to be in effective control of the Company, the acquisition of additional control of the Company by the same Person will not be considered a Corporate Transaction. For purposes of this definition, Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the Company. Notwithstanding the foregoing, to the extent that

any amount constituting deferred compensation (as defined in Section 409A of the Code) would become payable under this Plan by reason of a Corporate Transaction, such amount shall become payable only if the event constituting a Corporate Transaction would also qualify as a change in ownership or effective control of the Company or a change in the ownership of a substantial portion of the assets of the Company, each as defined within the meaning of Code Section 409A, as it has been and may be amended from time to time, and any proposed or final Treasury Regulations and IRS guidance that has been promulgated or may be promulgated thereunder from time to time.

"**Director**" means a member of the Board.

"**Disability**" means in the case of incentive stock options, total and permanent disability as defined in Section 22(e)(3) of the Code and in the case of other Awards, that the Participant is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months.

"**Dividend Equivalent Right**" means the right of a Participant, granted at the discretion of the Committee or as otherwise provided by the Plan, to receive a credit for the account of such Participant in an amount equal to the cash dividends paid on one Share for each Share represented by an Award held by such Participant.

"**Effective Date**" means the date this Plan is approved by the Company's stockholders, the date of which shall be within twelve (12) months before or after the date this Plan is adopted by the Board.

"**Employee**" means any person, including Officers and Directors, employed by the Company or any Parent, Subsidiary or Affiliate. Neither service as a Director nor payment of a director's fee by the Company will be sufficient to constitute "employment" by the Company.

"**Exchange Act**" means the United States Securities Exchange Act of 1934, as amended.

"**Exercise Price**" means, with respect to an Option, the price at which a holder may purchase the Shares issuable upon exercise of an Option and with respect to a SAR, the price at which the SAR is granted to the holder thereof.

"**Fair Market Value**" means, as of any date, the value of a share of the Company's Common Stock determined as follows:

(a) if such Common Stock is publicly traded and is then listed on a national securities exchange, its closing price on the date of determination on the principal national securities exchange on which the Common Stock is listed or admitted to trading as reported in The Wall Street Journal or such other source as the Board or the Committee deems reliable;

(b) if such Common Stock is publicly traded but is neither listed nor admitted to trading on a national securities exchange, the average of the closing bid and asked prices on the date of determination as reported in The Wall Street Journal or such other source as the Board or the Committee deems reliable; or

(c) if none of the foregoing is applicable, by the Board or the Committee in good faith.

"**Insider**" means an officer or director of the Company or any other person whose transactions in the Company's Common Stock are subject to Section 16 of the Exchange Act.

"**IRS**" means the United States Internal Revenue Service

"**Non-Employee Director**" means a Director who is not an Employee of the Company or any Parent, Subsidiary or Affiliate.

"**Option**" means an award of an option to purchase Shares pursuant to Section 5 or Section 12 of the Plan.

"**Parent**" has the same meaning as "parent corporation" in Section 424(e) of the Code.

"**Participant**" means a person who holds an Award under this Plan.

"**Performance Award**" means cash or stock granted pursuant to Section 10 or Section 12 of the Plan.

"**Performance Factors**" means any of the factors selected by the Committee and specified in an Award Agreement, from among the following objective measures, either individually, alternatively or in any combination, applied to the Company as a whole or any business unit or Subsidiary, either individually, alternatively, or in any combination, on a GAAP or non-GAAP basis, and measured, to the extent applicable on an absolute basis or relative to a pre-established target, index, or other companies, to determine whether the performance goals established by the Committee with respect to applicable Awards have been satisfied:

- Profit Before Tax;
- Sales;

- Expenses;
- Billings;
- Revenue;
- Net revenue;
- Earnings (which may include earnings before interest and taxes, earnings before taxes, net earnings, stock-based compensation expenses, depreciation and amortization);
- Operating income;
- Operating margin;
- Operating profit;
- Controllable operating profit, or net operating profit;
- Net Profit;
- Gross margin;
- Operating expenses or operating expenses as a percentage of revenue;
- Net income;
- Earnings per share;
- Total stockholder return;
- Market share;
- Return on assets or net assets;
- The Company's stock price;
- Growth in stockholder value relative to a pre-determined index;
- Return on equity;
- Return on invested capital;
- Cash Flow (including free cash flow or operating cash flows);
- Balance of cash, cash equivalents and marketable securities;
- Cash conversion cycle;
- Economic value added;
- Individual confidential business objectives;
- Contract awards or backlog;
- Overhead or other expense reduction;
- Credit rating;
- Completion of an identified special project;
- Completion of a joint venture or other corporate transaction;
- Strategic plan development and implementation;
- Succession plan development and implementation;
- Improvement in workforce diversity;
- Employee satisfaction;
- Employee retention;
- Customer indicators and satisfaction;
- New product invention or innovation;
- Research and development expenses;
- Attainment of research and development milestones;
- Improvements in productivity;
- Bookings;
- Working-capital targets and changes in working capital; and
- Attainment of objective operating goals and employee metrics.

The Committee may, in recognition of unusual or non-recurring items such as acquisition- related activities or changes in applicable accounting rules, provide for one or more, equitable adjustments (based on objective standards) to the Performance Factors to preserve the Committee's original intent regarding the Performance Factors at the time of the initial award grant. It is within the sole discretion of the Committee to make or not make any such equitable adjustments.

"**Performance Period**" means one or more periods of time, which may be of varying and overlapping durations, as the Committee may select, over which the attainment of one or more Performance Factors will be measured for the purpose of determining a Participant's right to, and the payment of, a Performance Award.

"**Performance Share**" means an Award granted pursuant to Section 10 or Section 12 of the Plan, the payment of which is contingent upon achieving certain performance goals established by the Committee.

"**Performance Unit**" means a right granted to a Participant pursuant to Section 10 or Section 12, to receive Stock (or cash or a combination thereof), the payment of which is contingent upon achieving certain performance goals established by the Committee.

"**Permitted Transferee**" means any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law (including adoptive relationships) of the Employee, any person sharing the Employee's

household (other than a tenant or employee), a trust in which these persons (or the Employee) have more than 50% of the beneficial interest, a foundation in which these persons (or the Employee) control the management of assets, and any other entity in which these persons (or the Employee) own more than 50% of the voting interests.

"**Plan**" means this Shutterfly, Inc. 2015 Equity Incentive Plan.

"**Purchase Price**" means the price to be paid for Shares acquired under the Plan, other than Shares acquired upon exercise of an Option or SAR.

"**Restricted Stock Award**" means an award of Shares pursuant to Section 6 or Section 12 of the Plan, or issued pursuant to the early exercise of an Option.

"**Restricted Stock Unit**" means an Award granted pursuant to Section 9 or Section 12 of the Plan.

"**SEC**" means the United States Securities and Exchange Commission.

"**Securities Act**" means the United States Securities Act of 1933, as amended.

"**Shares**" means shares of the Company's Common Stock and the common stock of any successor security.

"**Stock Appreciation Right**" means an Award granted pursuant to Section 8 or Section 12 of the Plan.

"**Stock Bonus**" means an Award granted pursuant to Section 7 or Section 12 of the Plan.

"**Subsidiary**" has the same meaning as "subsidiary corporation" in Section 424(f) of the Code.

"**Termination**" or "**Terminated**" means, for purposes of this Plan with respect to a Participant, that the Participant has for any reason ceased to provide services as an employee, officer, director, consultant, independent contractor or advisor to the Company or a Parent or Subsidiary of the Company. An employee will not be deemed to have ceased to provide services in the case of (i) sick leave, (ii) military leave, or (iii) any other leave of absence approved by the Committee; *provided*, that such leave is for a period of not more than 90 days, unless reemployment upon the expiration of such leave is guaranteed by contract or statute or unless provided otherwise pursuant to formal policy adopted from time to time by the Company and issued and promulgated to employees in writing. In the case of any employee on an approved leave of absence, the Committee may make such provisions respecting suspension of vesting of the Award while on leave from the employ of the Company or a Parent or Subsidiary of the Company as it may deem appropriate, except that in no event may an Award be exercised after the expiration of the term set forth in the applicable Award Agreement. In the event of military leave, if required by applicable laws, vesting will continue for the longest period that vesting continues under any other statutory or Company approved leave of absence and, upon a Participant's returning from military leave (under conditions that would entitle him or her to protection upon such return under the Uniform Services Employment and Reemployment Rights Act), he or she will be given vesting credit with respect to Awards to the same extent as would have applied had the Participant continued to provide services to the Company throughout the leave on the same terms as he or she was providing services immediately prior to such leave. An employee will have terminated employment as of the date he or she ceases to provide services (regardless of whether the termination is in breach of local laws or is later found to be invalid) and employment will not be extended by any notice period or garden leave mandated by local law. The Committee will have sole discretion to determine whether a Participant has ceased to provide services for purposes of the Plan and the effective date on which the Participant ceased to provide services (the " **Termination Date** ").

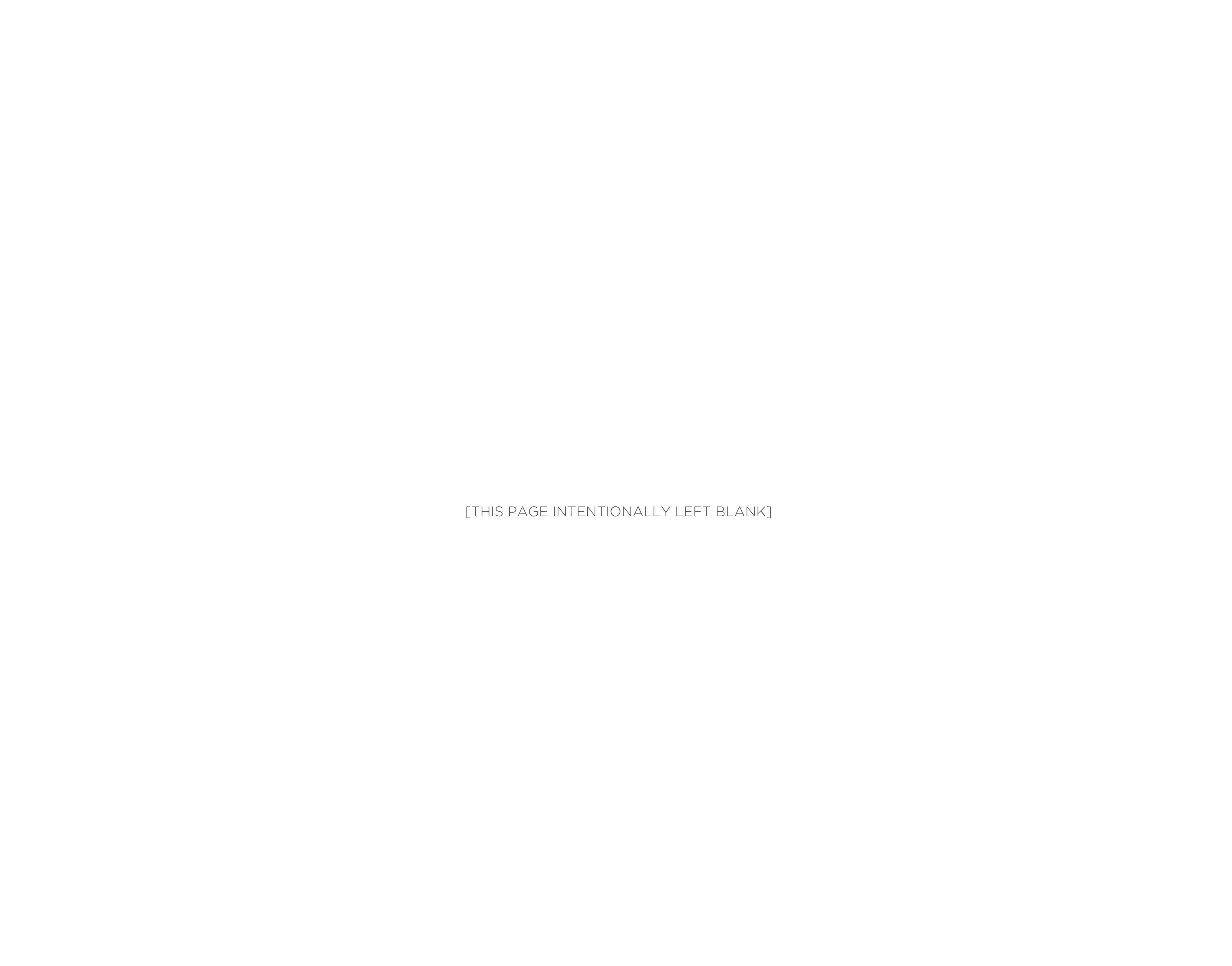
"**Treasury Regulations**" means regulations promulgated by the United States Treasury Department.

"**Unvested Shares**" means Shares that have not yet vested or are subject to a right of repurchase in favor of the Company (or any successor thereto).

02

2018 ANNUAL REPORT

INC


[THIS PAGE INTENTIONALLY LEFT BLANK]

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2018

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 001-33031

SHUTTERFLY, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock, $0.0001 Par Value Per Share	The Nasdaq Global Select Market

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

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

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

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

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

Large accelerated Filer ☑	Accelerated Filer ☐
Non-accelerated Filer ☐	Smaller reporting company ☐
Emerging growth company ☐	

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

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

As of June 29, 2018, the last business day of our most recently completed second fiscal quarter, the aggregate market value of our Common Stock held by non-affiliates based on the closing price of our Common Stock on June 29, 2018 as reported on The Nasdaq Global Select Market was $3,005,286,895.

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

CLASS	OUTSTANDING AT FEBRUARY 25, 2019
Common stock, $0.0001 par value per share	34,066,317

DOCUMENTS INCORPORATED BY REFERENCE

Designated portions of the Proxy Statement relating to our 2019 Annual Meeting of the Stockholders (the "Proxy Statement") have been incorporated by reference into Part III (Items 10, 11, 12, 13 and 14) of this Form 10-K, as specified in the responses to the item numbers involved. Except for information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended December 31, 2018.

SHUTTERFLY, INC.
TABLE OF CONTENTS

Part I

2 **ITEM 1.** BUSINESS

13 Item 1A. Risk Factors

36 Item 1B. Unresolved Staff Comments

37 **ITEM 2.** PROPERTIES

37 **ITEM 3.** LEGAL PROCEEDINGS

38 **ITEM 4.** MINE SAFETY DISCLOSURES

Part II

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

40 **ITEM 6.** SELECTED FINANCIAL DATA

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

67 Item 7A. Quantitative and Qualitative Disclosures about Market Risk

69 **ITEM 8.** FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

118 Item 9A. Controls and Procedures

119 Item 9B. Other Information

Part III

120 **ITEM 10.** DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

120 **ITEM 11.** EXECUTIVE COMPENSATION

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

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

120 **ITEM 14.** PRINCIPAL ACCOUNTING FEES AND SERVICES

Part IV

121 **ITEM 15.** EXHIBITS AND FINANCIAL STATEMENT SCHEDULE

124 **ITEM 16.** FORM 10-K SUMMARY

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This report, including the following Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are based upon our current expectations. These forward-looking statements include statements related to our business strategy and plans, restructuring activities, technology and production systems initiatives, the seasonality of and growth of our business, the impact on us of general economic conditions, trends in key metrics such as total number of customers, total number of orders, and average order value, our capital expenditures for 2019, the sufficiency of our cash and cash equivalents and cash generated from operations for the next 12 months, our operating expenses remaining a consistent percentage of our net revenue, our manufacturing capabilities, our new production facilities, effective tax rates, our acquisition of Lifetouch, Inc. and related statements regarding the integration of Shutterfly's and Lifetouch, Inc.'s businesses, as well as other statements regarding our future operations, financial condition and prospects and business strategies. In some cases, you can identify forward-looking statements by terminology such as "guidance," "believe," "anticipate," "expect," "estimate," "intend," "seek," "continue," "should," "would," "could," "will," "plan," or "may," or the negative of these terms or other comparable terminology. Forward-looking statements involve risks and uncertainties. Our actual results and the timing of events could differ materially from those anticipated in our forward-looking statements as a result of many factors, including but not limited to, decreased consumer discretionary spending as a result of general economic conditions; our ability to expand our customer base and increase sales to existing customers; our ability to meet production requirements; our ability to attract and retain management and other personnel; our ability to retain and hire necessary employees, including seasonal personnel, and appropriately staff our operations; the impact of seasonality on our business; our ability to develop innovative, new products and services on a timely and cost-effective basis; failure to realize the anticipated benefits of our 2017 restructuring activities or of the Lifetouch acquisition; recent and ongoing restructuring activities (including but not limited to those relating to manufacturing consolidation, Lifetouch field operations and our single platform migration); the exploration of strategic alternatives may not result in any transaction being consummated; consumer acceptance of our products and services; our ability to develop additional adjacent lines of business; unforeseen changes in expense levels; a deterioration in the relationship with any of our business partners; refining our promotional strategies; competition and the pricing strategies of our competitors, which could lead to pricing pressure; a failure to implement new technology systems; a decline in participation rate in the Lifetouch business; the retention of Lifetouch employees and our ability to successfully integrate the Lifetouch businesses; risks inherent in the achievement of anticipated synergies and the timing thereof; general economic conditions and changes in laws and regulations and the other risks set forth below under "Risk Factors" in Part II, Item 1A of this report. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. We assume no obligation to update any of the forward-looking statements after the date of this report or to compare these forward-looking statements to actual results.

As used herein, "Shutterfly," "the Company," "we," "us," "our," and similar terms include Shutterfly, Inc. and its subsidiaries, unless the context indicates otherwise.

Part I

ITEM 1. BUSINESS.

Overview

Shutterfly, Inc. ("Shutterfly") is the leading retailer and manufacturing platform for personalized products and communications and was incorporated in the state of Delaware in 1999. In September 2006, we completed our initial public offering and our common stock is listed on The Nasdaq Global Select Market under the symbol "SFLY." Our principal corporate offices are in Redwood City, California.

On April 2, 2018, we completed our acquisition of Lifetouch Inc. ("Lifetouch") for an all-cash purchase price of $825.0 million. Lifetouch is the national leader in school photography, built on the enduring tradition of "Picture Day," and serves families through portrait studios and other partnerships.

Shutterfly Consumer and Lifetouch help consumers capture, preserve, and share life's important moments through professional and personal photography, and personalized products. The Shutterfly brand brings photos to life in photo books, gifts, home décor, and cards and stationery. Lifetouch is the national leader in school photography, built on the enduring tradition of "Picture Day," and also serves families through portrait studios and other partnerships. Shutterfly Business Solutions delivers digital printing services that enable efficient and effective customer engagement through personalized communications.

We also offer Shutterfly Photos, our cloud photo management service, to our customers. During fall picture day season in 2018, Lifetouch school customers who purchased digital images from mylifetouch.com were able to access these pictures directly within Shutterfly Photos. These customers benefited from free storage for any personal photos they uploaded as well as their Lifetouch photos, and were able to create and purchase personalized products using these photos. Our experience shows that integrating customers' photos onto Shutterfly Photos is the best way to drive customer engagement and purchases of our products.

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

Shutterfly Consumer leads the industry in personalized photo products and services. Shutterfly Consumer helps our customers turn their precious memories into lasting keepsakes with cards and stationery, award-winning professionally-bound photo books, personalized gifts and home décor as well as calendars and prints.

The **Tiny Prints boutique** offers premium cards and stationery, stylish announcements, invitations and personal stationery. The Tiny Prints boutique provides customers exclusive luxe designs curated from top stationery designers. Customers seek us out for our industry-leading designs and exceptional service.

BorrowLenses is a premier online marketplace for high-quality photographic and video equipment rentals.

Groovebook is an iPhone and Android app and subscription service that prints up to 100 mobile phone photos in a Groovebook and mails it to customers every month.

Lifetouch is the national leader in school photography, built on the enduring tradition of "Picture Day." **School Photography** captures K-12 portraits and helps high school and college seniors celebrate those graduation milestones and yearbooks. Our P**ortrait Studios** provide professional photographic services for infants, toddlers, families and business professionals throughout the United States under the JCPenney portrait brand at over 400 retail studios. Lifetouch also captures pictures of infants to toddlers for **Preschools** and daycares nationwide and provides **Churches** and other groups with pictorial directories and images for purchase.

In addition to these consumer brands, **Shutterfly Business Solutions ("SBS")** provides personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for our business customers.

We generate most of our revenue by marketing and manufacturing a variety of products such as portraits, cards and stationery, professionally-bound photo books and yearbooks, personalized gifts and home décor, and calendars and high-quality prints. We manufacture many of these items in our production facilities located throughout the United States and one in Canada.

By operating our own production facilities, we can produce high-quality products, innovate rapidly, maintain a favorable cost structure and ensure timely shipment to customers, even during peak periods of demand. We also operate a network of partners, across which we can seamlessly manage demand. Some of the products that are currently manufactured for us by third-parties include calendars, mugs, ornaments, candles, pillows and blankets.

While Lifetouch is a leading school photographer in Canada, substantially all our revenue is generated from sales originating in the United States. Shutterfly Consumer and Lifetouch sales have historically been highly seasonal. For example, approximately 50% of our Shutterfly Consumer net revenue occurs during our fiscal fourth quarter. In the fourth quarter, the traditional fall school and holiday portraits generate approximately 35% of Lifetouch's annual revenue. We also see an increase in Lifetouch net revenue during the second quarter in connection with the spring portrait season and yearbooks. Our operations and financial performance depend on general economic conditions in the United States, consumer sentiment, and the levels of consumer discretionary spending. We closely monitor these economic measures as their trends are indicators of the health of the overall economy and are some of the key external factors that impact our business.

Our Lifetouch business is based on securing opportunities at schools, preschools, retailers and other organizations to capture unique images of infants, toddlers, children, teenagers, high school and college seniors, adults and families. Through Lifetouch's arrangements with these "hosts," Lifetouch captures the images of more than 25 million individuals each year and serves over 10 million households. Through our acquisition of Lifetouch, we potentially gain access to these Lifetouch customers for our Shutterfly Consumer business. Lifetouch has over 11 million non-overlapping three-year active customers (defined as customers who have made at least one purchase from Lifetouch in the last three years). Over time, Lifetouch's customers will benefit from Shutterfly's leading cloud-photo management service ("Shutterfly Photos"), product creation capabilities, mobile apps, and broad product range. We expect to realize more revenue from Lifetouch customers within Lifetouch by accelerating the development of Lifetouch's online ordering platforms as well as potentially offering some of Shutterfly's broader product range to customers. We also expect to realize supply chain, manufacturing, and fulfillment synergies over time.

Our plans for cost synergies center on establishing a common manufacturing platform, achieving greater utilization given our adjacent peak periods (the third quarter for Lifetouch and the fourth quarter for Shutterfly Consumer), and leveraging our combined purchasing power and scale. As part of our strategic planning process for 2019, we further developed our long-term plans to establish a single, next-generation manufacturing platform serving Shutterfly Consumer, Lifetouch and SBS. We refer to this initiative as Project Aspen.

In conjunction with Project Aspen, we plan to open a new 237,000 square foot facility in Texas in the first half of 2020, which will serve all of our segments. We will also close four legacy Lifetouch facilities in 2019: Loves Park, Illinois; Bloomington, Minnesota; Chico, California; and Chattanooga, Tennessee, and will consolidate this volume into existing Shutterfly facilities and the new facility in Texas. The consolidation involves a mix of moving existing Lifetouch equipment to Shutterfly facilities and migrating Lifetouch volumes to Shutterfly's digital presses. Given the adjacent peak periods of the Shutterfly Consumer and the Lifetouch businesses, this consolidation of facilities will provide an opportunity to reduce our reliance on temporary labor while improving the utilization of existing assets. We plan to retain a portion of the impacted employees in this transition, who will move to other existing Shutterfly or Lifetouch facilities, and we will offer appropriate severance and/or retention packages to other employees.

In addition to the customer acquisition opportunities made possible through our acquisition of Lifetouch, we will continue to acquire customers through multiple marketing channels including search engine marketing ("SEM") (e.g. Google), social media marketing (e.g. Facebook) and display marketing. Close, frequent customer interactions, coupled with significant investments in sophisticated integrated marketing programs, enable us to obtain user input on new features, functionalities and products. We continue to fine-tune and tailor our promotions and website presentation to specific customer segments. Consequently, our Shutterfly customers are presented with a highly personalized shopping experience, which helps foster a unique and deep relationship with our Shutterfly business.

To successfully execute our strategies, we require a talented leadership team. This is even more

critical as we integrate our acquisition of Lifetouch. As a result, we intend to continue our focus to attract, retain, and grow our team; and to build continuity and pursue executional excellence in our daily operations everywhere. Lifetouch is also highly dependent on field sales and photo operations teams, which have a core year-round employee base, supplemented by a large number of seasonal employees. By providing our employees with a great place to work, we believe that we continue to strengthen our high-performance culture.

On February 5, 2019, we announced that Christopher North, President and CEO, will be stepping down at the end of August 2019, and that the Board of Directors has engaged an executive search firm to identify candidates to succeed him. Additionally, the Board of Directors has formed a Strategic Review Committee (the "Strategic Review Committee") and retained a financial advisor, as it continues an ongoing review of strategic and financial alternatives. As part of this review, we affirmed our objective of maintaining gross leverage of 2.5-3.0x Adjusted EBITDA on an annual basis, and to return cash in excess of our operating and financing needs to shareholders in the form of share repurchases, within the parameters of appropriate cash management that meets the needs of our highly seasonal business, where substantially all of our cash flow is generated in the last four months of the year.

Segment Information

On April 2, 2018, we completed the acquisition of Lifetouch. Because of the acquisition, we have a new operating segment for the Lifetouch business. Our reportable segments are Shutterfly Consumer, Lifetouch, and Shutterfly Business Solutions.

Shutterfly Consumer

Our Shutterfly Consumer revenue includes sales from our brands and are derived from the sale of a variety of products such as cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and prints, and related shipping revenues, as well as rental revenue from our BorrowLenses brand. Revenue from advertising displayed on our website is also included in Shutterfly Consumer revenues. Shutterfly Consumer revenue as a percentage of total net revenue was 49% in 2018, 84% in 2017 and 88% in 2016.

Lifetouch

Our Lifetouch revenue is primarily from professional photography services for schools, preschools and retail studios operated by Lifetouch under the JCPenney Portrait brand as well as churches and other groups. Lifetouch revenue as a percentage of total net revenue was 39% in 2018, which is measured from the date of our acquisition on April 2, 2018.

SBS

Our SBS revenue is primarily from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for our business customers. We continue to focus our efforts in expanding our presence in this industry. SBS revenues as a percentage of total net revenue was 12% in 2018, 16% in 2017 and 12% in 2016.

For financial information about each segment, see Part II, Item 7 of this annual report on Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations-Basis of Presentation" and Part II, Item 8 of this annual report on Form 10-K, "Financial Statements and Supplementary Data-Notes to Consolidated Financial Statements-Note 15-Segment Reporting." For a discussion of the operational risks associated with each business segment, see Part I, Item 1A of this annual report on Form 10-K, "Risk Factors."

Strategy

Looking forward, value creation will come from continuing to drive growth in all three of our segments, from delivering substantial cost and revenue synergies from the Lifetouch integration, and from returning capital to shareholders.

- Driving growth in all three of our segments

  In the Shutterfly Consumer segment, we will continue to build on our success in mobile, in broader range of products, in category expansion, and in the reacceleration of personalized gifts and home décor while making improvement in our prints and our holiday cards offering, supported by marketing and promotional investments.

  In the Lifetouch segment, we will continue to drive account growth in schools and preschools. We are looking to improve our participation rate through awareness supported by direct-to-consumer communications.

  In the SBS segment, we will continue to focus on servicing our existing large customers and landing large new customers.

- Delivering substantial cost and revenue synergies from our Lifetouch acquisition

  With the Lifetouch integration, we are focused on realizing three main value creation opportunities. First, we intend to gain access to many Lifetouch customers as Shutterfly customers; second, we expect to realize more revenue from Lifetouch customers within Lifetouch by accelerating the development of Lifetouch's online ordering platform and offering products from Shutterfly's broader range; and third, we anticipate gaining significant supply chain, manufacturing, and fulfillment synergies. We will be continuing our path towards a single manufacturing platform to realize cost synergies.

- Returning capital to shareholders

  Our objective is to maintain gross leverage of 2.5-3.0x Adjusted EBITDA on an annual basis, and to return cash in excess of our operating and financing needs to shareholders in the form of share repurchases, within the parameters of appropriate cash management that meets the needs of our highly seasonal business, where substantially all of our cash flow is generated in the last four months of the year.

Business Initiatives

Pivot towards Mobile.

Mobile is a core element of our growth strategy itself with the percentage of revenue coming from mobile sources for the Shutterfly brand increasing five percentage points for each of the last two years. We will continue to add more products to the app and iterate on our simplified and intuitive creation paths. We will make significant enhancements to our shopping experience and navigation to support discovery even as our product catalog expands, and give greater prominence to personalized campaigns and automatically created products in the app. Our mobile platform has a strong focus on monetization, optimizing conversion to first purchase and driving customer lifetime value through expanded use of impulse buy and cross-sell campaigns. We expect to continue to acquire new customers to mobile whom we would not have acquired on the web, and over time, we expect to create mobile-first and mobile-only experiences as well.

During 2018, we continued to make progress on our mobile app, launching more than 60 new products. During the third quarter we began pushing our machine learning models into the mobile app, so that we can use customers' local photos on the phone for automated product creation, alongside their cloud-based photos. Photos on the phone are typically the most recent, and recency is a strong predictor of purchase. Our new "Made for You" tile on the home screen of the mobile app, which offers automatically generated products featuring customers' most relevant photos, is powered by these models. This tile has resulted in statistically significant lift in revenue per customer versus a control group. We also launched a new app-exclusive program called "Free Book A Month," which presents pre-created photo books meant to be purchased as an impulse buy, with the goal of acquiring new customers and driving more frequent purchases. With the expanded catalog and a new app storefront, it is easier for users to find products easily. In 2018, the percentage of revenue coming from mobile sources for the Shutterfly brand increased to 28% from 23% in 2017 and 18% in 2016. We continued to see a high install-to-first order ratio and attractive customer acquisition costs for the app, with customers acquired via the mobile app having a superior return on investment ("ROI") versus customers acquired via desktop browser.

Offer Customers a Broader Range of Products.

Throughout Shutterfly's history, category expansion and new product launches have been reliable drivers of growth. We envision a future where we offer the broadest possible selection of premium, personalized products. In 2018, we launched two new product categories, Kids and Pets, while continuing to launch additional product types in the Home Décor and Personalized Gifts categories and making improvements in our Prints and holiday cards offering. We also expect to reduce the cost and time to launch a new product to further accelerate the pace of product introduction in 2019 and beyond. Further, we expect our next major category launch to be in early 2020.

We continue to simplify the process of creating and purchasing personalized products. In 2018 we launched a new shopping cart experience, offering interoperability between using a browser and our mobile app. The new cart significantly improves the speed of checkout and is far more scalable to our peak needs. We have also simplified how we present our pricing to customers, making it easier to understand the discount they receive at every stage of the purchase path and reducing the need to enter discount codes. At the same time, we have continued the shift in our sales offerings away

from free promotions and toward paid purchases, which reduces our reliance on our most aggressive promotions, improves the quality of our revenue, and protects our premium brand position.

As a result of re-engineering our new product launch processes, we reduced the time and cost to launch new products in 2018 with twice as many new products launched in 2018 than in 2017. We have also removed the dependency on our new products launch process from our annual technology road map to allow for more rapid decision-making. We are now able to work from a backlog of products to continuously launch new products throughout the calendar year. We have also been able to identify partners and lower cost locations where we can outsource certain part of the process. Our holiday card range includes approximately 1,400 designs in 2018; 800 for Shutterfly and 600 for Tiny Prints, with more than 75% of card designs being new.

We're also proud of our execution against technology and manufacturing, with significant year-over-year improvements in the speed and availability of our site, apps, and upload experiences. We have also further simplified product creation, automatically cropping and laying out the photos selected by customers in the card or gift of their choice. Our manufacturing platform set new records for quality, delivery speed, and customer service, benefiting from the platform consolidation, process improvements, and equipment upgrades. We continue to reduce our dependency on temporary labor, launching our first robotic automation project, which was used on our Gifts product in the fourth quarter of 2018.

Reacceleration of Personalized Gifts and Home Décor.

Our Personalized Gifts and Home Décor ("PGHD") delivered a significant re-acceleration of growth, in part thanks to the faster rate of new product introductions with 47 new products in 2018, double the number launched in 2017. During the third quarter of 2018 we also added two new categories on Shutterfly.com: Kids and Pets. These two categories are targeted to children and pet lovers who love to personalize their belongings and make a statement. The product offerings range from kids' room décor to school supplies and pet accessories such as bandannas, ID tags and pet blankets. The Kids category also includes a new line of personalized children's storybooks with licensed content from third parties including Nickelodeon. Further, we expect our next major category launch to be in early 2020.

Improvement in Prints and Holiday Cards Offering.

Improving our holiday card offer is a critical priority in 2019. We expect to have a good / better / best range strategy, optimizing customer acquisition across Shutterfly and Tiny Prints. Shutterfly will continue to have a mass premium offering for our existing loyal customers, but will create a more compelling offering for our value-oriented customers. Tiny Prints will be the focus of our differentiated, premium offering. Our brand spend will also support reinforcing Shutterfly as the definitive place for holiday cards.

Marketing and Promotional Investments.

To support our business strategies, we use a variety of integrated marketing programs, including strategic marketing partnerships, e-mail marketing to prospects and existing customers, search engine marketing ("SEM"), search engine optimization ("SEO"), affiliate marketing, display advertising, traditional direct marketing mailings such as postcards and seasonal catalogs, print advertising and other broadcast media. In addition, because many of our products are either shared over the Internet or given as gifts, the appearance of our brands on the products and packaging provides ongoing advertising. During the fourth quarter we also combined algorithmic targeting with marketing automation technology to begin delivering personalized marketing messages and promotions tailored to the recipient. Throughout 2018, we deployed dozens of highly integrated channel campaigns with a balance of direct response and brand awareness. We invested in new channels and in new content innovation that spotlights our key categories of cards, gifting, pets and storybooks. We also entered into partnerships with high profile celebrity influencers during the 2018 holiday season. We are continuing our philanthropic partnerships with the Make-a-Wish Foundation and The Ellen Show, a partnership which entered its seventh season in 2018.

Our goal is to improve and, over time, radically simplify every aspect of the creation and purchasing process. We plan to continue to build on the progress we have already made in simplifying the creation and purchase of personalized products, focusing on personalization and targeting across the entire customer journey, ranging from personalized marketing using the customer's most relevant photographs, to highly targeted promotions, to products automatically created for customers.

We upgraded our suite of marketing tools and platforms in the first half of 2018, implementing best-in-class third-party platforms, improving our promotional tools to allow more flexible and targeted promotions, building expanded up-sell and cross-sell capabilities, increasing our use of machine-learning-based targeting algorithms, and continuing to expand automated product creation. At the same time, we'll continue to focus on improving speed and availability. And, as we work towards that long-term vision, we will seek to improve the customer experience we offer today to decrease friction, increase speed, and continue to inspire our customers.

During the fourth quarter of 2018, we announced the appointment of Mickey Mericle as Senior Vice President and Chief Marketing Officer as marketing and promotions are a key area of focus for 2019 in our Shutterfly Consumer segment. Having on-boarded our new Chief Marketing Officer and a new pricing leader, increased the flexibility of our promotional platform, and integrated best-in-class third-party marketing platforms in 2018, we aim to drive deeper, more personalized engagement with our customers in 2019.

Cost and Revenue Synergies from the Lifetouch Acquisition.

Our plans for cost synergies arising from our acquisition of Lifetouch center on establishing a common manufacturing platform, achieving greater utilization given our adjacent peak periods, and leveraging our combined purchasing power and scale. We will be closing four Lifetouch facilities in 2019: Loves Park, Illinois; Bloomington, Minnesota; Chico, California and Chattanooga, Tennessee and will consolidate this volume into existing Shutterfly facilities and the new facility in Texas. Given the adjacent peak periods of the Shutterfly Consumer and the Lifetouch businesses, this consolidation of facilities will further provide opportunity to reduce our reliance on temporary labor while improving the utilization of existing assets.

During the fall picture day season in 2018, Lifetouch Schools customers who purchased digital images from mylifetouch.com were able to access these pictures directly within Shutterfly Photos, our fully-featured cloud photos service on Shutterfly.com. These customers were able to benefit from free storage for any personal photos they upload as well as their Lifetouch photos, and were able to create and purchase personalized products using all of these photos. Our experience is that integrating customers' photos onto Shutterfly is by far the best way to drive customer engagement and purchase. This initial technology integration phase is our first step in reaching a small set of customers; we expect modest revenue synergies for these activities in 2019 but are working towards much deeper integration and larger revenue synergies in 2019 and beyond.

We continue to see a number of levers to impact the Lifetouch growth rate, including continued account growth, average order value ("AOV"), and participation rate. A significant driver of participation is awareness, and in 2019, we will further develop our tools and programs to drive awareness, including investing in building marketing teams, integrating platforms, and developing programs, and increasing the portion of the customer base we can reach with direct-to-consumer communications.

SBS Growth.

We believe customers are coming to SBS because we provide value at a level much above a traditional printer. We have already demonstrated that we can leverage our existing capabilities to build an entirely new business to a new set of customers, providing variable and just-in-time printing needs and driving volume through our fixed-cost infrastructure and our network of third-party vendors. SBS historically has built dedicated systems to support each large customer and we are now building a scalable platform that enables any of our clients to optimize their integrated marketing campaigns. We intend to leverage this work to obtain additional SBS customers. Over time, we expect to leverage our manufacturing platform to serve a broader set of Enterprise customers and business use-cases above and beyond SBS. In 2017, we took advantage of an opportunity to complete the upgrade of the majority of our color printer fleet that enabled us to improve quality, increase throughput and automation, and lower consumable costs. In 2019, we expect to continue to deliver further improvements on quality, cost, automation, reliance on seasonal labor and speed of delivery.

Technology and Production Systems

We intend to continue our efforts to make improvements in our platform and infrastructure including migration to a modern service-oriented architecture, cloud migration big data strategy and analytics, e-commerce development, and manufacturing scale and automation. The scale and scope economies from our vertically integrated manufacturing and supply chain enable us to extend our competitive position and improve overall customer satisfaction, further strengthening our competitive position.

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

Customer relationship management or CRM system.

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

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

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

Website system.

We have designed our website systems to be secure and highly available within a managed data center as well as within leading public clouds. We can scale to increasing numbers of customers cost-effectively by adding relatively inexpensive industry-standard computers and servers and by scaling our use of public clouds. We have a strong commitment to our privacy policy, and we utilize technologies such as firewalls, encryption technology for secure transmission of personal information between customers' computers and our website system, and intrusion detection systems.

Image archive.

We store our customers' images in our datacenter-hosted image archive as well as public clouds. Once a customer uploads a photo to our website, it is copied to redundant storage systems. We continue to expand our storage capacity by leveraging public cloud as well as our datacenter to meet increasing customer demand. The combination of our storage systems (cloud, datacenter) provides low storage costs, facilitates the safe, secure archiving of customers' images and delivers the speed and performance required to enable customers to access and enhance their images in real-time.

Render farm.

Once a customer orders a photo or any photo-based product, our render farm technology performs fully automated image processing on the image prior to production. Except for 4x6 and 5x7 prints, the customer's original uploaded image is retrieved from the storage system for production purposes. The render farm applies automatic algorithms to enhance the color, contrast and sharpness to every image before it is sent to production, unless the customer has explicitly chosen not to do so. The render farm also performs customer-requested edits such as crop, borders, customized back-printing and red-eye removal.

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

Field Operations, Photographer Scheduling and Sales Management.

We use a combination of third party and proprietary systems and algorithms in order to support a large and geographically dispersed operations for our Lifetouch segment. These systems help support a large variety of hosts and field capacity that increases significantly in peak seasons.

Photo Capture Systems.

We currently operate several proprietary photo capture systems and studios. These systems are designed for their respective environments and attempt to automate and simplify the photography process to enable photographers to focus on engaging with the subject and to capture genuine expression. In addition, they control for variability in order to optimize quality

and efficient production. Many of the capture systems also provide for photographed subject knock-out capabilities which increases the selection of different looks and backgrounds and enhances customer choice efficiently.

To ensure accurate data collection and photo distribution, we utilize several proprietary processes and systems. These capture mechanisms are designed for simplicity to allow the photographer to focus on photography in high volume environments while still maintaining accuracy.

Production system.

We currently operate our own production facilities in Fort Mill, South Carolina; Tempe, Arizona; and Shakopee, Minnesota as well as several smaller facilities operated by our Lifetouch teams. Our automated production system controls our production processes, including order management and pick, pack and ship operations. Using proprietary algorithms, the production system analyzes large numbers of orders daily and automates the workflow into our state-of-the-art digital presses.

Shutterfly Photos.

We also made progress toward our vision of creating a world-class memory management service connected to our personalized e-commerce solutions with Shutterfly Photos. By modernizing our technology platform and developing new customer-friendly features, we have addressed the friction points caused by multiple devices, fragmented storage options, and limited organization and search capabilities for interacting with photos and videos.

Competition

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

- Online digital photography services companies such as Snapfish, Vistaprint, and many others;
- Social media companies that host and enable mobile access to and posting of images such as Facebook, Instagram, Twitter, Pinterest, Snapchat and Google+;
- Photo hosting websites that allow users to upload and share images at no cost such as Apple iCloud and Google Photos;
- “Big Box” retailers such as Wal-Mart, Costco, Sam’s Club, Target, and others that offer low cost digital photography products and services. In addition to providing low-cost competitive product offerings on their respective websites, these competitors provide in-store fulfillment and self-service kiosks for printing, and may, among other strategies, offer their customers heavily discounted in-store products and services that compete directly with our offerings;
- Drug stores such as Walgreens, CVS/ pharmacy, and others that offer low-cost photography products and services as well as in-store pick-up from their photo website Internet orders;
- Traditional offline stationery companies such as PaperSource, Crane & Co., and Papyrus;
- Cloud-based storage services and file-syncing services such as Dropbox, Box, Everalbum, Amazon Photos and iCloud;
- Specialized companies in the photo book and stationery business such as Hallmark, Cardstore by American Greetings, Minted, Invitations by Dawn, Picaboo, Blurb, Mixbook, Postable, Artifact Uprising and Chatbooks;
- Photo-related software companies such as Apple, Microsoft, and Adobe;
- Online and offline companies specializing in photo-based merchandise and personalized home décor such as Zazzle, CafePress, Art.Com, Canvas On Demand, Personalization Mall, Personal Creations, Things Remembered, Mark & Graham, CustomInk, Teespring and Etsy.
- Providers of digital alternatives to our products, such as Paperless Post, Evite, Animoto, and PicCollage.
- Home printing service providers such as Hewlett-Packard and Epson that are seeking to expand their printer and ink businesses by gaining market share in the digital photography marketplace;
- Enterprise digital and print communications companies such as RR Donnelley and Sons Company, O’Neil Data Systems, Inc., Quad/ Graphics, Inc. and Viatech Publishing Solutions, Inc.;
- Regional photography companies such as Ritz Camera that have established brands and customer bases in existing photography markets;

- Camera and photographic supply companies that rent equipment nationwide both online and in brick-and-mortar stores such as LensRentals.com, Cameralends, AbelCine, and Adorama;
- Picture People and Portrait Innovations in the Lifetouch portrait studio business;
- Independent professional and amateur photographers who enjoy low barriers to entry and can offer flexible business terms and product options in the school photography, church photography and retail studio photography businesses;
- Primarily local and regional players that compete with the Lifetouch School photography business, including Inter-State Studio & Publishing, Barksdale School Portraits, Strawbridge Studios and Dorian Studio in the United States and Artona Group, Edge Imaging, Mountain West Studios and Pegasus School Images in Canada; and
- Jostens, Herff Jones, Balfour and Walsworth Publishing in yearbooks (all of whom have made significant investments in technology) in addition to several online yearbook providers such as Tree Ring and Picaboo.

We believe the primary competitive factors in attracting and retaining customers are brand recognition and trust, quality of products and services, breadth of products and services, user affinity and loyalty, customer service, ease of use, convenience, and price.

We believe that we compete favorably with respect to many of these factors, particularly customer trust and loyalty, quality and breadth of products and services, and customer service. Many of our competitors promote their products based on low prices or the convenience of same-day availability for digital photos printed in drugstores or other retail outlets. While we offer exciting and new promotions to ensure we are price competitive, we also distinguish our offering with design, quality and innovation.

Intellectual Property

Protecting our intellectual property rights is part of our strategy for continued growth and competitive differentiation. We seek to protect our proprietary rights through a combination of patent, copyright, trade secret and trademark law. We enter into confidentiality and proprietary rights agreements with our employees, consultants and business partners, and control access to and distribution of our proprietary information. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights to third parties.

As of December 31, 2018, we had 143 issued patents, which expire at various dates between 2019 and 2036, and more than 30 patent applications pending in the United States. Our issued patents and patent applications relate primarily to intelligent product creation; image uploading, sharing, and editing; ordering and sharing products; cloud image storage infrastructure; machine learning; manufacturing optimization; mobile and social media technologies; and automated and personalized manufacturing. We intend to pursue corresponding patent coverage in additional countries to the extent we believe such coverage is appropriate and cost efficient. However, we cannot be certain that any of our pending or any future applications will be granted. In addition, third parties could bring invalidity, co-inventorship or similar claims with respect to any of our currently issued patents or any patents that may be issued to us in the future.

Our primary brands are "Shutterfly," "Lifetouch," "Prestige Portraits," "Tiny Prints," "Wedding Paper Divas," and "BorrowLenses". We hold applications and/or registrations for the Shutterfly, Lifetouch Prestige Portraits, Tiny Prints, Wedding Paper Divas, BorrowLenses and Goovebook trademarks in our major territories of the United States and Canada, as well as in the European Community. We also hold applications and registrations for the Shutterfly trademark in Mexico, Japan and China, and for the Shutterfly and Tiny Prints trademarks in Australia and New Zealand. We own the domains Shutterfly.com, mylifetouch.com, TinyPrints.com, BorrowLenses.com and Groovebook.com among others.

Government Regulation

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

services for activities of their users are currently unsettled both within the United States and abroad.

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

- The CAN-SPAM Act of 2003, similar laws adopted by a number of states, the Telephone Consumer Protection Act of 1991 and Canada's Anti-Spam Law. These laws are intended to regulate unsolicited commercial emails, create criminal penalties for unmarked sexually-oriented material and e-mails containing fraudulent headers, regulate our ability to market to U.S. consumers by phone or text messaging, and control other abusive online marketing practices.
- The Communications Decency Act ("CDA"), which gives statutory protection to online service providers who distribute third-party content.
- The Digital Millennium Copyright Act ("DMCA"), which is intended to reduce the liability of online service providers for listing or linking to third-party websites that include materials that infringe copyrights or other rights of others.
- The Children's Online Privacy Protection Act and the Prosecutorial Remedies and Other Tools to End Exploitation of Children Today Act of 2003, which are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.
- The California Consumer Privacy Act ("CCPA") was signed into law on June 28, 2018 and takes effect on January 1, 2020. It applies to entities that do business in California and imposes a number of additional requirements, such as disclosure obligations associated with the personal information that they collect, sell or disclose, including the purposes for which the personal information will be used. The CCPA also grants Californians new rights over their personal information, including for example rights to access personal information, request deletion of the information, and opt out of the sale of such information. The CCPA also includes anti-discrimination provisions that limit businesses' ability to deny services, charge different prices, or offer different qualities of service to consumers who exercise their rights.
- The Illinois Biometric Information Privacy Act (the "IBIPA"), which was passed by the Illinois General Assembly in October 2008, which guards against the unlawful collection and storing of biometric information.
- Statutes adopted in the State of California and other states, require online services to report certain breaches of the security of personal data, and to report to consumers when their personal data might be disclosed to direct marketers.
- The Family Educational Rights in Privacy Act ("FERPA"), Connecticut's Act Concerning Student Privacy (Public Act No. 16-189), Colorado's Student Data Transparency and Security Act (16 CRS 22) and Canadian privacy statutes which regulate the way entities can collect and handle school data as well as contract with schools for services.
- The Personal Information Protection and Electronic Documents Act of 2000 ("PIPEDA") and substantially similar provincial laws which govern how private sector organizations collect, use and disclose personal information in the course of commercial activities.
- The federal Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD Act") includes provisions governing the use of gift cards, including specific disclosure requirements and a prohibition or limitation on the use of expiration dates and fees. Each state regulates gift cards in its own manner, so long as in concert with the CARD Act. Several states are attempting to pass new laws regulating the use of gift cards and amending state escheatment laws to try to pass new laws regulating the use of gift cards and amending state escheatment laws to try and obtain unused gift card balances.
- The Restore Online Shoppers' Confidence Act ("ROSCA") prohibits and prevents Internet-based post-transaction third-party sales and imposes specific requirements on negative option features.
- The Patient Protection and Affordable Care Act (the "Patient Act"), as well as other healthcare reform legislation being considered

by Congress and state legislatures. Changes to our healthcare costs structure could increase our employee healthcare-related costs.

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

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

Employees

As of December 31, 2018, we had 7,094 full time employees. Below is a summary of employees by function as of December 31, for each of the last three years:

	2018(1)	2017	2016
Cost of revenue	3,823	987	1,018
Technology and development	695	533	585
Sales and marketing	2,153	236	290
General and administrative	423	178	191
TOTAL	**7,094**	**1,934**	**2,084**

(1) Employees of Lifetouch are included in 2018.

During the fall school picture day and peak holiday season, we hire contract workers on a temporary basis directly and from third-party outsourcing firms. For example, during our peak production period in the third and fourth quarter of 2018, we used approximately 12,500 temporary workers to assist in our photography, production and fulfillment operations. None of our employees are represented by a labor union or are covered by a collective bargaining agreement. We have never experienced any employment-related work stoppages and consider our employee relations to be good.

Available Information

Our Internet website is located at https://www.shutterflyinc.com. The information on our website is not a part of this annual report on Form 10-K. We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports

filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). Our SEC reports can be accessed through the investor relations section of our Internet website.

The public may also read and copy any materials we file with the Securities and Exchange Commission at its website at https://www.sec.gov.

ITEM 1A. RISK FACTORS

Risks Related to Our Business and Industry

The recently completed acquisition of Lifetouch, Inc. ("Lifetouch") presents many risks and we may not realize our anticipated financial and strategic goals.

On April 2, 2018, we completed our acquisition of Lifetouch, the national leader in school photography. Risks we may face in connection with the acquisition of Lifetouch include:

- We may not realize the benefits we expect to receive from the transaction, such as anticipated synergies, increasing revenue and enhanced financial position;
- We may have difficulties managing the acquired company's technologies and lines of business; or entering into a new business where we have no or limited direct prior experience;
- The acquisition may not further our business strategy as we expected, we may not successfully integrate Lifetouch as planned, there could be unanticipated adverse impacts on Lifetouch's business, or we may not otherwise realize the expected return on our investments, which could adversely affect our business or operating results and potentially cause impairment to assets that we record as a part of an acquisition including intangible assets and goodwill;
- Our operating results or financial condition may be adversely impacted by (1) claims or liabilities that we assume from Lifetouch including, among others, claims from government agencies, terminated employees, current or former customers or business partners, former employee stock ownership plan (ESOP Plan) participants or other third parties; (2) pre-existing contractual relationships of Lifetouch that we would not have otherwise entered into, the termination or modification of which may be costly or disruptive to our business; (3) unfavorable accounting treatment as a result of Lifetouch's practices; and (4) intellectual property claims or disputes;
- Our ability to successfully manage the various Lifetouch businesses, which operate in a more decentralized manner than Shutterfly, and, in particular, the sales territory organization structure;
- Lifetouch was a privately-held company and has not been required to maintain an internal control infrastructure that would meet the standards of a public company, including the requirements of the Sarbanes-Oxley Act of 2002. The implementation of such controls may impair business operations, the costs that we may incur to implement such controls and procedures may be substantial and we could encounter unexpected delays and challenges in this implementation. In addition, we may discover significant deficiencies or material weaknesses in the quality of Lifetouch's financial and disclosure controls and procedures and any of these things could impact our ability to timely file our periodic reports;
- Lifetouch's large workforce means greater compliance burden and increased risks of class action lawsuits, regulatory actions and potential claims or audits from governmental agencies;
- We may fail to find and retain enough qualified seasonal employees given an increase in competition;
- We may fail to identify or assess the magnitude of certain liabilities, shortcomings or other circumstances existing prior to acquiring Lifetouch, which could result in unexpected litigation or regulatory exposure, unfavorable accounting treatment, unexpected increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, operating results or financial condition; and
- We may have difficulty incorporating Lifetouch's related supply chain operations with our existing supply chain infrastructure and maintaining uniform standards, controls, procedures and policies.

The occurrence of any of these risks could have a material adverse effect on our business, results of operations, financial condition or cash flows.

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

Our business is highly seasonal, with a high proportion of our net revenue, net income and operating cash flows generated during the fourth quarter for both our Shutterfly consumer business and our Lifetouch business. For example, we generated approximately 50% of our net revenue in the fourth quarter during each of the last three years in our Shutterfly consumer business and Lifetouch generated approximately 35% of its net revenue in the fourth calendar quarter during each of the last three years. In addition, we incur significant additional expenses in the period leading up to Shutterfly's fourth quarter holiday season and Lifetouch's third quarter fall school portrait season and retail holiday season (our peak times), including expenses related to the hiring and training of temporary workers to meet our seasonal needs, additional inventory and equipment purchases, and increased advertising. We face intense competition for seasonal and temporary workers; with respect to Lifetouch's seasonal photographers, this difficulty may be exacerbated now that the ESOP has been terminated. If we are unable to accurately forecast expense levels, our results of operations would likely be negatively impacted. Additionally, if we are unable to accurately forecast and respond to consumer demand for our products during the fourth quarter, or if there is a meaningful decrease in demand for Lifetouch fall school photo day during the third quarter, our financial results, reputation and brands will suffer and the market price of our common stock would likely decline.

We also base our operating expense budgets on expected net revenue trends. A portion of our expenses, such as office, production facility, and various equipment leases and personnel costs, are largely fixed and are based on our expectations of our peak levels of operations. In addition, we must effectively manage the ramp-up and ramp-down of variable labor to achieve our expectations. Failure to accurately forecast or ineffectively manage such spikes can result in unexpected revenue or operating income shortfall. Accordingly, any shortfall in net revenue may cause significant variation in operating results in any quarter, particularly in the third and fourth quarters

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

We believe that we must continue to upgrade and expand our current production capability to meet our projected net revenue targets. Our capital expenditures were approximately 5%, 6% and 8% of total net revenue for the years ended December 31, 2018, 2017 and 2016, respectively. The expenditures will continue to increase with the Lifetouch acquisition. Operational difficulties, such as a significant interruption in the operations of our production facilities or in facilities operated by third-parties, could delay production or shipment of our products. In addition, inclement weather, particularly heavy rain and snow could impair our production capabilities. Our inability to meet our production requirements, particularly in our peak season, could lead to customer dissatisfaction, impact Lifetouch's account retention, and damage our reputation and brands, which would result in reduced net revenue.

Moreover, if the costs of meeting production requirements, including capital expenditures, were to exceed our expectations, our results of operations would be harmed.

In addition, at peak times, we face significant production risks, including the risk of obtaining sufficient qualified seasonal production personnel. Most of our workforce during these periods has historically been comprised of seasonal, temporary personnel. We have had difficulties in the past finding and retaining enough qualified seasonal employees, and our failure to find and retain qualified seasonal production personnel at any of our production facilities could harm our operations.

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

Our financial performance depends on general economic conditions and their impact on levels of consumer spending in the United States, particularly on personalized products and photofinishing services and professional photography and in Canada on Lifetouch's school business. Shutterfly consumer net revenue as a percentage of total net revenue was 49% in 2018, 84% in 2017 and 88% in 2016; substantially all of Lifetouch's revenue was derived from consumers during these periods. Some of the macroeconomic conditions that can adversely affect consumer spending levels in the United States include domestic and foreign stock market volatility and its effects on net worth, anticipated economic slowdowns in foreign economies, high consumer

debt levels, uncertainty in real estate markets and home values, fluctuating energy and commodity costs, rising or higher than average interest rates, higher than usual unemployment rates, limited credit availability, changes in tax laws, and general uncertainty about the future economic environment. If general economic conditions decline, customers or potential customers could delay, reduce or forego their purchases of our products and services, which are discretionary. Any decrease in the demand for our products and services could impact our business several ways, including lower prices for our products and services and reduced sales. In addition, adverse economic conditions may lead to price increases by our suppliers or increase our operating expenses due to, among other factors, higher costs of labor, energy, equipment and facilities which could in turn lead to additional restructuring actions by us and associated expenses. We may not be able to pass these increased costs on to our customers due to the macroeconomic environment and the resulting increased expenses and/or reduced income could have a material adverse impact our operating results.

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

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

Changes in our pricing strategies have had, and may continue to have, a significant impact on our net revenue and net income. For example, in the second and third quarters of 2018 we saw a deceleration of revenue associated with free promotions that impacted our top line consumer revenue. As we continue to implement more optimized and targeted pricing strategies, we cannot predict with certainty that these changes will have the expected impacts. From time to time, we have made changes to our pricing structure to remain competitive. Many of our products, including professionally-bound photo books, calendars, cards and stationery and other photo merchandise are also offered by our competitors. Many of our competitors discount those products at significant levels and as a result, we may be compelled to change our discounting strategy, which could impact our acquisition of new customers, average order value, net revenue, gross margin, and adjusted EBITDA and net income profitability measures. If in the future, due to competitor discounting or other marketing strategies, we significantly reduce our prices on our products without a corresponding increase in volume, it would negatively impact our net revenue and could adversely affect our gross margins and overall profitability.

We generate a significant portion of our net revenue from the fees we collect from shipping and handling of our products. For example, shipping and handling revenue for the Shutterfly brand website represented approximately 22% of our net revenue in 2018, 23% of our net revenue in 2017 and 19% in 2016. We also offer discounted or free shipping, with a minimum purchase requirement, during promotional periods to acquire and retain customers. If free shipping offers extend beyond a limited number of occasions, are not based upon a minimum purchase requirement or become commonplace, our net revenue and results of operations would be negatively impacted. In addition, we occasionally offer free or discounted products and services to acquire and retain customers. In the future, if we increase these offers to respond to actions taken by our competitors, our results of operations may be harmed.

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

The digital photography products and services industry is intensely competitive, and we expect competition to increase in the future as current competitors improve their offerings, including developing, acquiring and expanding mobile and cloud-based offerings, and as new participants enter the market or as industry consolidation further develops. Competition may result in pricing pressures, reduced profit margins or loss of market share, any of which could substantially harm our business and results of operations. For example, we saw a significantly greater marketing presence and more aggressive promotional activity from competitors in the fourth quarter in 2018 as compared to recent years, with competition both at the value and premium ends of the spectrum. We face intense competition from a wide range of companies, including the following:

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

- Social media companies that host and enable mobile access to and posting of images such as Facebook, Instagram, Twitter, Pinterest, Snapchat and Google+;
- Photo hosting websites that allow users to upload and share images at no cost such as Apple iCloud, Google Photos, and Flickr;
- "Big Box" retailers such as Wal-Mart, Costco, Sam's Club, Target, and others that offer low cost digital photography products and services. In addition to providing low-cost competitive product offerings on their respective websites, these competitors provide in-store fulfillment and self-service kiosks for printing, and may, among other strategies, offer their customers heavily discounted in-store products and services that compete directly with our offerings;
- Drug stores such as Walgreens, CVS/pharmacy, and others that offer low-cost photography products and services as well as in-store pick-up from their photo website Internet orders;
- Traditional offline stationery companies such as PaperSource, Crane & Co., and Papyrus;
- Cloud-based storage services and file-syncing services such as Dropbox, Box, Everalbum, Amazon Photos and iCloud;
- Specialized companies in the photo book and stationery business such as Hallmark, Cardstore by American Greetings, Minted, Invitations by Dawn, Picaboo, Blurb, Mixbook, Postable, Artifact Uprising and Chatbooks;
- Photo-related software companies such as Apple, Microsoft, and Adobe;
- Online and offline companies specializing in photo-based merchandise and personalized home décor such as Zazzle, CafePress, Art.Com, Canvas On Demand, Personalization Mall, Personal Creations, Things Remembered, Mark & Graham, CustomInk, Teespring and Etsy.
- Providers of digital alternatives to our products, such as Paperless Post, Evite, Animoto, and PicCollage.
- Home printing service providers such as Hewlett-Packard and Epson that are seeking to expand their printer and ink businesses by gaining market share in the digital photography marketplace;
- Enterprise digital and print communications companies such as RR Donnelley and Sons Company, O'Neil Data Systems, Inc., Quad/Graphics, Inc. and Viatech Publishing Solutions, Inc.;
- Regional photography companies such as Ritz Camera that have established brands and customer bases in existing photography markets;
- Camera and photographic supply companies that rent equipment nationwide both online and in brick-and-mortar stores such as LensRentals.com, Cameralends, AbelCine, and Adorama;
- Picture People and Portrait Innovations in the Lifetouch portrait studio business;
- Independent professional and amateur photographers who enjoy low barriers to entry and can offer flexible business terms and product options in the school photography, church photography and retail studio photography businesses;
- Primarily local and regional players that compete with the Lifetouch School photography business, including Inter-State Studio & Publishing, Barksdale School Portraits, Strawbridge Studios and Dorian Studio in the United States and Artona Group, Edge Imaging, Mountain West Studios and Pegasus School Images in Canada; and
- Jostens, Herff Jones, Balfour and Walsworth Publishing in yearbooks (all of whom have made significant investments in technology) in addition to several online yearbook providers such as Tree Ring and Picaboo.

Many of our competitors, particularly in the Shutterfly Consumer and SBS segments, have significantly longer operating histories; larger and broader customer bases, greater brand and name recognition; greater financial, research and development and distribution resources, and operate in more geographic areas than we do. Well-funded competitors may be better able to withstand economic downturns and periods of slow economic growth and the associated periods of reduced customer spending and increased pricing pressures. The numerous choices for digital photography services can cause confusion for consumers and may cause them to select a competitor with greater name recognition. Some competitors can devote substantially more resources to website and systems development or to investments or partnerships with traditional and online competitors. Well-funded competitors, particularly new entrants, may choose to prioritize growing their market share and brand awareness

instead of profitability. Competitors and new entrants in the digital photography products and services industry may develop new products, technologies or capabilities that could render obsolete or less competitive many of our products, services and content. We may be unable to compete successfully against current and future competitors, and competitive pressures could harm our business and prospects

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

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

- demand for our products and services, including seasonal demand;
- our success in executing our pricing, market and general business strategy;
- our ability to attract visitors to our websites, convert those visitors into customers and encourage repeat purchases;
- the amount and timing of our operating and capital expenses;
- our ability to manage our production and fulfillment operations;
- the costs to produce our prints and photo-based products and merchandise to provide our services;
- the costs of expanding or enhancing our technology or websites;
- a significant increase in returns and credits, beyond our estimated allowances, for customers who are not satisfied with our products;
- the slower secular growth of our core-paper based products business, including the increasing commodification in the Prints business;
- decreases in travel, including declines or disruptions to the travel industry and variations in weather, particularly heavy rain and snow which tend to depress travel and picture taking;
- the potential impact of the current U.S political climate on consumer spending;
- the timing of holidays and the duration of the holiday shopping season which will be shorter in 2019 than it was in 2018;
- natural disasters or other events resulting in school closures could lead to cancellations or postponements of scheduled picture days, and could also impact Lifetouch's school business operations in the field and/or production facilities;
- our ability to achieve the expected benefits of strategic partnerships or the loss of any such partnership;
- our ability to address increased shipping delays caused by our third-party shippers' inability to handle the ever-increasing number of consumers ordering goods online, particularly during the holiday shopping season;
- volatility in our stock price, which may lead to higher stock-based compensation expense;
- the deterioration of our business relationships with our Lifetouch hosts, including schools, preschools, and other organizations as well as retailers like JCPenney;
- general economic conditions, including recession and slow economic growth in the United States and worldwide and higher inflation;
- consumer preferences for digital photography services;
- improvements to the quality, cost and convenience of desktop printing of digital pictures and products;
- continued decline in church or house of worship attendance which impact Lifetouch's church division; and
- global and geopolitical events with indirect economic effects such as pandemic disease, hurricane and other natural disasters, war, threat of war or terrorist actions.

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

There can be no assurance that our exploration of strategic alternatives will result in any transaction being consummated, and speculation and uncertainty regarding the outcome of our exploration of strategic alternatives may adversely impact our business.

On February 5, 2019, the Company announced that its Board of Directors has formed a Strategic Review Committee and retained Morgan Stanley as financial advisor, as it continues an ongoing review of strategic and financial alternatives. The Strategic Review Committee is also evaluating the Company's capital structure and capital return policy. There can be no assurance that any transaction will be consummated, and the process of exploring strategic and financial alternatives will involve the dedication of significant resources and the incurrence of significant costs and expenses. In addition, speculation and uncertainty regarding our exploration of strategic and financial alternatives may cause or result in:

- disruption of our business;
- distraction of our management and employees;
- difficulty in recruiting, hiring, motivating, and retaining talented and skilled personnel;
- difficulty in maintaining or negotiating and consummating new, business or strategic relationships or transactions;
- increased stock price volatility; and
- increased costs and advisory fees.

If we are unable to mitigate these or other potential risks related to the uncertainty caused by our exploration of strategic and financial alternatives, it may disrupt our business or adversely impact our revenue, operating results, and financial condition.

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

Our success depends, in large part, on our ability to identify, hire, integrate, retain and motivate qualified executives and other key employees throughout all areas of our business. Identifying, developing internally or hiring externally, training and retaining highly-skilled senior management, technical, marketing and production personnel are critical to our future, and competition for experienced employees can be intense. Additionally, the current uncertainty around U.S. immigration rules could impact our ability to attract and retain qualified employees. We face significant competition for qualified personnel in all locations where we operate, including in the San Francisco Bay Area, where our headquarters are located and in Eden Prairie, Minnesota, where our Lifetouch principal office is located. We may be unable to attract and retain suitably qualified individuals who can meet our growing operational and managerial requirements, or we may be required to pay increased compensation to do so. Failure to successfully hire executives and key employees or the loss of any executives and key employees could have a significant impact on our operations. Further, a lack of management continuity could result in operational, technological, and administrative inefficiencies and added costs, which could adversely impact our results of operations and stock price and may make recruiting for future management positions more difficult.

Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees and senior executives could hinder our strategic planning and execution. We hired a new Chief Marketing Officer in October 2018. On February 5, 2019, we announced that Christopher North, our President, Chief Executive Officer and member of our Board, will be stepping down at the end of August 2019. We currently have not hired a replacement Chief Executive Officer. Our search process, which is being led by the Board, to identify a candidate for Chief Executive Officer continues, and we continue to work with an executive search firm to assist with the process of identifying, evaluating and recruiting candidates. There are no assurances concerning the timing or outcome of our search for a new Chief Executive Officer. Our ability to execute our business strategies, ensure a cohesive management team, and attract and retain key executives may be adversely affected by the uncertainty associated with the transition to a successor President and Chief Executive Officer.

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

We have periodically experienced operating losses since our inception in 1999. In particular, we make investments in our business that generally result in operating losses in each of the first three quarters of our fiscal year. This typically has enabled us to generate the majority of our net revenue during the fourth quarter and to achieve profitability for the full fiscal year. If we are unable to produce our products and provide our services

at commercially reasonable costs, if consumer demand decreases and net revenue decline or if our expenses exceed our expectations, we may not be able to achieve, sustain or increase profitability on a quarterly or annual basis.

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

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

- maintain and increase the size of our customer base;
- increase the number of schools and preschools we serve;
- maintain and enhance our brands;
- enhance and expand our products and services;
- continue to develop and upgrade our technology and information processing systems, including our enterprise resource planning (“ERP”) system;
- increase the participation rate at Lifetouch
- maintain and grow our websites, applications and customer operations;
- successfully execute our business and marketing strategy;
- continue to enhance our service to meet the needs of a changing industry;
- provide a high-quality customer experience, including superior customer service and timely product deliveries;
- respond to competitive developments; and
- attract, integrate, retain and motivate qualified personnel.

We may be unable to accomplish one or more of these requirements, which could cause our business to suffer. Accomplishing one or more of these requirements might be very expensive, which could harm our financial results.

If we are unable to acquire customers, or do so in a cost-effective manner, traffic to our websites would be reduced and our business and results of operations would be harmed.

Our success depends on our ability to attract customers and grow our active customer base, specifically in a cost-effective manner. On a net basis, our active customer base for Shutterfly Consumer has been relatively flat for the past three years. We rely on a variety of methods to bring visitors to our websites and mobile applications and promote our products, including paying fees to third parties who drive new customers to our websites and mobile applications, purchasing search results from online search engines, e-mail and direct mail marketing campaigns. We pay providers of online services, search engines, social media, advertising networks, directories and other websites and e-commerce businesses to provide content, advertising/media and other links that direct customers to our websites. We also use e-mail and direct mail to attract customers, and we offer substantial pricing discounts or free products to encourage repeat purchases and trial orders. For Lifetouch, our marketing efforts also include flyers distributed by our hosts, radio advertising and television advertising. Our methods of attracting customers, including acquiring customer lists from third parties can involve substantial costs, regardless of whether we acquire new customers as a result of such purchases. Even if we are successful in acquiring and retaining customers, the cost involved in these efforts, and which has increased in recent years, especially as we shift our sales offerings from free to paid products, impacts our results of operations. Customer lists are typically recorded as intangible assets and may be subject to impairment charges if the fair value of that list exceeds its carrying value. These potential impairment charges could harm our results from operations. If we are unable to enhance or maintain the methods we use to reach consumers, if the costs of acquiring customers using these methods significantly increase, or if we are unable to develop new cost-effective methods to obtain customers, our ability to attract new customers would be harmed, traffic to our websites and mobile applications may be reduced and our business and results of operations would be harmed.

Our sales to SBS customers can be unpredictable, can require significant ramp-up periods in the early stages of SBS contracts, and a decrease in SBS revenue or an increase in costs of SBS net revenue could adversely impact total net revenue and profit levels.

SBS revenue as a percentage of total net revenue was 12% in 2018, 16% in 2017 and 12% in 2016. SBS gross margins were 19% in 2018, 20% in 2017 and 26% in 2016. The declining gross margins of this segment, coupled with the increasing percentage of total revenue from SBS, may magnify the impact of variations in revenue and operating costs on our operating results. This may have an

adverse effect on our overall margins and profitability. Our SBS revenue is highly concentrated in a small number of customers and the loss of, or reduction in volume from, one or more of our SBS customers could decrease SBS revenue and adversely impact our total net revenue. Our SBS customers also come from a variety of industries, often creating regulatory compliance issues for us as well as the need to maintain security for third-party data. These SBS customers also demand strict security requirements and specified service levels. If we fail to meet these service levels, we may not only lose an SBS customer, but may have to pay punitive costs for such failures. As our SBS business grows, issues that impact our sales to SBS customers may have a negative impact on our total sales. Our core business is consumer focused and we have less experience managing sales to SBS customers and may not sell as successfully to SBS customers, who often have long sales cycles, long implementation periods and significant upfront costs. In addition, we had in 2017 and 2018, and may continue to have in the future, low or no gross margins in the early stages of our contracts with SBS customers that often require significant ramp-up periods, which will adversely affect our total net revenue. To compete effectively in the SBS industry, we have in the past, and may in the future, be forced to offer significant discounts to large SBS customers at lower margins or reduce or withdraw from existing relationships with smaller SBS customers, which could negatively impact our net revenue and could adversely affect our gross margins and overall profitability.

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

The primary costs in operating our business are related to producing and shipping products, acquiring customers, compensating our personnel, acquiring equipment and technology, and leasing facilities. Controlling our business costs is challenging because many of the factors that impact these costs are beyond our control. For example, the costs to produce prints, such as the costs of photographic print paper, could increase due to a shortage of silver or an increase in worldwide energy, oil or fuel prices. Higher fuel prices have a corresponding increase in travel-related expenses of our Lifetouch photographers. Changes in federal and state minimum wage laws could raise the wage requirements for certain of our seasonal personnel, which could increase the pressure, particularly on Lifetouch, in hiring seasonal photographers and production workers; we may also experience competitive pressure to increase the wages paid to a large population of our employees resulting from other industry participants increasing wage levels. In addition, we may become subject to increased costs by the third-party shippers that deliver our products to our customers, and we may be unable to pass along any increases in shipping costs to our customers. The costs of online advertising and keyword search could also increase significantly due to increased competition, which would increase our customer acquisition costs. Local land use and other regulations restricting the construction and operation of our production facilities, the adoption of local laws restricting our operations and environmental regulations, may increase the cost of sites and of constructing, leasing and operating our production facilities. If we are unable to keep the costs associated with operating our business aligned with the level of net revenue that we generate, our results of operations would be adversely affected.

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

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

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

The number of people who access information about our services and our websites through mobile devices, including smartphones and handheld tablets or computers, has increased significantly in recent years and is expected to continue increasing. As part of our multichannel strategy, we are making technology investments in our mobile websites and our iOS and Android applications. If customers do not adopt our applications and mobile website as expected, or if we are generally unable to make, improve, or develop relevant customer-facing mobile technology in a timely manner, our ability to compete could be adversely affected and may result in the loss of market share, which could harm our results of operations. In addition, if our technology systems do not function as designed, we may experience a loss of confidence, data security breaches or lost sales, which could adversely affect our reputation and results of operations. As new mobile devices and platforms are released, it is difficult to predict the problems we may encounter in developing products and applications for these alternative devices and platforms, and we may need to devote significant resources to the creation, support, and maintenance of such products and applications. If we experience difficulties providing satisfactory access to our services via our mobile applications and mobile websites, such as, problems with our relationships with providers of mobile operating systems (e.g., Apple or Google and their application stores) our growth and customer acquisition and retention capabilities may be impaired. In addition, increased distribution costs of the applications may impact net revenue growth and negative reviews due to our software and user experience may damage our brand reputation and lead to customer churn.

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

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

Portions of our infrastructure, especially our photos domain for Shutterfly Photos, have run on a public cloud service (Amazon Web Services, Inc. or "AWS") for several years. Since the third quarter of 2017, Shutterfly has added additional workloads to AWS thereby expanding the portions of our infrastructure which run on a public cloud service, and we intend to continue to expand our use of AWS. Any disturbances in the AWS system may create unforeseen technical issues, which would negatively influence our business and reputation. Although we leverage the redundancy features available from our public cloud service provider, any outage to their infrastructure could adversely impact our site availability, potentially leading to poor customer experience and data loss. For instance, in December 2017, researchers identified significant CPU architecture vulnerabilities commonly known as "Spectre" and "Meltdown" that required AWS software updates and patches to mitigate such vulnerabilities and such updates and patches required AWS servers to be offline and slowed their performance.

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

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

This risk is heightened in the fourth quarter, as we experience significantly increased traffic to our websites during the holiday season and significantly higher order volumes. Any interruption that occurs during such time would have a disproportionately negative impact on our results of operations than if it occurred during a different quarter. For example, during the fourth quarter of 2018, a technical issue in our newly built shopping cart service caused a partial outage that prevented some customers from placing orders on Cyber Monday. Even after the issue was identified and corrected, many of those orders were not received by customers within the expected time frame. As a result, we refunded many of those orders which reduced net revenue, recognized excess costs related to expedited shipping upgrades, and increased customer service costs which negatively impacted our gross margins and our brand.

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

Any failure by us to protect the confidential information of our customers and employees, and our networks against security breaches and the risks associated with credit card fraud could damage our reputation and brands and substantially harm our business and results of operations.
A significant prerequisite to e-commerce and communications is the secure transmission of confidential information over public networks. We may be subject to cyber-attacks, phishing attacks, malicious software programs, and other attacks in the future. These attacks may come from individual hackers, criminal groups, and state-sponsored organizations. Our failure to prevent security breaches could damage our reputation and brands and substantially harm our business and results of operations. Even though we do not store customer credit cards on our computer system and use third-party systems to clear transactions, in case of an outage to a third-party system, we will temporarily store and bill our customers' credit card accounts directly; orders are then shipped to a customer's address and customers log on using their e-mail address. We rely on encryption and authentication technologies licensed from third parties to affect the secure transmission of confidential information, including credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography, hacking or other developments may result in a compromise or breach of the technology used by us to protect customer transaction data. In addition, any party who is able to illicitly obtain a user's password could access the user's transaction data, personal information or stored images. In addition to these threats, the security, integrity, and availability of our customers' and employees' data, including student photos, could be compromised by employee negligence, error or malfeasance, and technology defects. For example, due to the current status of Lifetouch's customer contact processes, there is risk of providing photo access to the wrong customer, which could lead to loss of business with school districts and lead to brand reputation damage.

Our expanded use of cloud-based services could also increase the risk of security breaches as cyber-attacks on cloud environments are increasing to almost the same level as attacks on traditional information technology systems. For example, in 2014, we experienced a cyber-attack on our Tiny Prints, Treat and Wedding Paper Divas websites, which may have exposed the email addresses and encrypted passwords used

by our customers to login to their accounts. We encrypt customer credit and debit card information, and we have no evidence that such information was compromised; however, any compromise of our security could damage our reputation and brands and expose us to a risk of loss or litigation and potential liability, which would substantially harm our business and results of operations. In addition, anyone who can circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may need to devote significant resources to protect against security breaches or to address problems caused by breaches. Additionally, in 2018, we discovered that there had been unauthorized access to an internal testing environment, which could have resulted in exposure of employee confidential data. Although we discovered no evidence to indicate exposure of this data, we cannot determine that it did not occur; while we have taken remediation and precautionary measures to prevent this type of situation from occurring again, we cannot guarantee that these measures will be effective.

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

If the third-party vendors who we depend upon to purchase our supplies, market our products, produce many of our products or deliver our product fail to perform under our agreements with them or experience delays or interruptions in service, our customer experience will suffer, which would substantially harm our business, reputation and results of operations.

Our ability to provide a high-quality customer experience depends, in large part, on external factors over which we may have little or no control, including the reliability and performance of our suppliers, third-party product providers and shipping partners. For example, some of our products, such as select photo-based merchandise, are produced and shipped to customers by our third-party vendors, and we rely on these vendors to properly inspect and ship these products. We purchase photo-based and other product supplies and photography equipment from third parties. These parties could increase their prices, reallocate supply to others, including our competitors, or choose to terminate their relationship with us. Furthermore, if any of our third-party suppliers are unable to produce our products, we could have difficulty finding an alternative producer in a timely manner. In the third quarter of 2018, a third-party supplier unexpectedly shut down, which combined with Hurricane Michael, affected the ability of another third-party supplier that had absorbed the increased capacity to meet our production needs during peak times. In addition, we rely on third-party shippers, including the U.S. Postal Service and UPS to deliver our products to customers. Strikes, furloughs, reduced operations, increased shipping delays particularly during the holiday shopping season, or other service interruptions affecting these shippers could impair our ability to deliver merchandise on a timely basis. We also currently outsource some of our off-line and online marketing, and some of our customer service activities to third parties. In the fourth quarter of 2015, a third-party customer service provider experienced a disruption that affected our operations during peak times. Our failure to provide customers with high-quality products in a timely manner for any reason or a failure to meet customer expectations could substantially harm our reputation and our efforts to develop trusted brands, which would substantially harm our business and results of operations.

Lifetouch's studio business is materially dependent upon JCPenney and any deterioration in Lifetouch's relationships with JCPenney or in JCPenney's business could have a material adverse effect on Lifetouch's revenue.

Substantially all of Lifetouch's studio business is derived from sales in JCPenney stores and is, therefore, materially dependent upon its relationship with JCPenney, the continued goodwill of JCPenney and the integrity of their brand names in the retail marketplace. In January 2019, JCPenney announced it would be closing three stores by the spring with additional closures potentially announced throughout the year. Lifetouch's portrait studios in JCPenney leverage customer traffic generated by the JCPenney retail

stores, and if the customer traffic through these stores decreases due to the weakness of the JCPenney business, further store closures, JCPenney chooses not to renew its agreement with us, general economic conditions or for any other reason, Lifetouch's sales could be materially and adversely affected.

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

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

We may experience difficulties implementing and maintaining our new enterprise resource planning system.

We purchased a new ERP system and are currently beginning its implementation. This system will replace many of our existing operating and financial systems. Such an implementation is a major undertaking, both financially and from a management and personnel perspective. Any disruptions, delays or deficiencies in the design and implementation of our new ERP system could adversely affect our ability to process orders, ship products, provide services and customer support, send invoices and track payments, fulfill contractual obligations or otherwise operate our business.

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

Since 2007, our board of directors has approved inducement equity awards outside of our 2006 Plan and 2015 Plan to select new employees upon hire and in connection with mergers and acquisitions without stockholder approval in accordance with Nasdaq Listing Rule 5635(c) for an aggregate of 3,338,561 shares of our common stock. The use of inducement equity awards may dilute the equity interest of our stockholders, which could in turn adversely affect prevailing market prices for our common stock.

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

If we were to become subject to e-mail blacklisting, traffic to our websites would be reduced and our business and results of operations would be harmed.

Various private entities attempt to regulate the use of e-mail for commercial solicitation. These entities often advocate standards of conduct or practice that significantly exceed current legal requirements and classify certain e-mail solicitations that comply with current legal requirements as unsolicited bulk e-mails, or "spam." Some of these entities maintain blacklists of companies and individuals, and the websites, Internet service providers and Internet protocol addresses associated with those entities or individuals that do not adhere to what the blacklisting entity believes are appropriate standards of conduct or practices for commercial

e-mail solicitations. If a company's Internet protocol addresses are listed by a blacklisting entity, e-mails sent from those addresses may be blocked if they are sent to any Internet domain or Internet address that subscribes to the blacklisting entity's service or purchases its blacklist. From time to time we are blacklisted, sometimes without our knowledge, which could impair our ability to sell our products and services, communicate with our customers and otherwise operate our business. In addition, we have noted that unauthorized "spammers" utilize our domain name to solicit spam, which increases the frequency and likelihood that we may be blacklisted.

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

We rely on Internet search engines such as Google, Yahoo! and Bing, including through the purchase of keywords related to photo-based products, to generate traffic to our websites. We obtain a significant amount of traffic via search engines and, therefore, utilize techniques such as search engine optimization ("SEO") and search engine marketing ("SEM") to improve our placement in relevant search queries. Search engines, including Google, Yahoo! and Bing, frequently update and change the logic that determines the placement and display of results of a user's search, such that the purchased or algorithmic placement of links to our websites can be negatively affected. Moreover, a search engine could, for competitive or other purposes, alter its search algorithms or results causing our websites to place lower in search query results. If a major search engine changes its algorithms in a manner that negatively affects our paid or unpaid search ranking, or if competitive dynamics impact the effectiveness of SEO or SEM in a negative manner, including but not limited to increased costs for desired search queries, our business and financial performance would be adversely affected, potentially to a material extent.

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

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

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

Although earlier in our history we have focused our business on consumer industry for silver halide prints, we have consistently evolved and broadened our offering to include other photo-based products, such as cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and other photo merchandise. We continually evaluate the demand for new products and services and the need to address trends in consumer demand and opportunities in the marketplace. For example, we have expanded in recent years into statement gifts and home décor, including wall art, ornaments and pillows, and video equipment rentals through the BorrowLenses brand, and we launched kids and pets categories in the second half of 2018. In the future, we may need to address additional segments and expand our customer demographic to grow our business. Our efforts to expand our existing services, create new products and services, address new segments or develop a significantly broader customer base may not be successful. Any failure to address additional opportunities could result in loss of market share, which would harm our business, financial condition and results of operations.

A decline in participation rate by customers in the Lifetouch school picture business and continued decrease in attendance of church services would have a negative impact on Lifetouch's revenue.

An important element of profitability in the school picture business is the participation rate (percentage of students photographed whose parents purchase the photo). The tradition of families purchasing an annual school photo of their child and/or the school yearbook could erode over time. Likewise, reduction in number of high school seniors who are photographed for the yearbook, combined with the availability of alternative digital platforms for commemorating school achievements, could make the traditional printed yearbook less compelling overall. Similarly, the continued secular decline in people attending church services could reduce the number of participants in our church business. The existence or continuation of such trends would result in the loss of customers as well as lower net revenue.

Failure to comply with privacy laws and regulations and failure to adequately protect customer data could harm our business, damage our reputation and result in a loss of customers.

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

The regulatory framework is constantly evolving, and privacy concerns could adversely affect our operation results.

The regulatory framework for privacy issues worldwide is currently evolving and is likely to remain uncertain for the foreseeable future. The occurrence of unanticipated events often rapidly drives the adoption of legislation or regulation affecting the use of data and the way we conduct our business; in fact, there are active discussions among U.S. legislators around adoption of a new U.S. federal privacy law. Restrictions could be placed upon the collection, management, aggregation and use of information, which could result in a material increase in the cost of collecting certain kinds of data. For example, the European Parliament formally adopted the General Data Protection Regulation (the "GDPR"), which established a new framework for data protection in Europe effective as of May 2018. The GDPR imposes more stringent operational requirements for entities processing personal information, such as stronger safeguards for data transfers to countries outside the European Union ("EU"), reliance on express consent from data subjects (as opposed to assumed or implied consent), a right to require data processors to delete personal data, and stronger enforcement authorities and mechanisms. In June of 2018, California enacted the CCPA, which will take effect on January 1, 2020. The CCPA has many similarities to the GDPR and imposes significant new obligations and limitations on businesses, including the Company, that collect and process personal information of California citizens. Complying with CCPA and changing domestic and international requirements may cause the Company to incur substantial costs, require the Company to change its business practices or reduce the overall demand for our business offerings, which could harm our financial condition and results of operations. Noncompliance could result in significant penalties or legal liability.

Lifetouch is uniquely subject to several student data privacy laws; any adverse publicity stemming from a data breach or failure to protect personal data (whether valid or perceived) could adversely affect Lifetouch's relationship with schools, districts, education associations and parent groups, leading to loss of future business.

In its role as a service provider to schools, Lifetouch is subject to various privacy laws and regulations including, without limitation, the Family Educational Rights in Privacy Act (FERPA), Connecticut's Act Concerning Student Privacy (Public Act No. 16-189), Colorado's Student Data Transparency and Security Act (16 CRS 22) and Canadian privacy statutes. In recent years (since 2014), numerous student privacy bills have been introduced and laws passed at the federal and state levels. These laws regulate the way

Lifetouch collects and handles the school data it relies on to conduct Picture Day, and the way Lifetouch contracts with schools for such services. Lifetouch also historically has relied on schools to distribute portrait packages and access credentials to parents. Newer methods enabling parents to order and receive their child's images online provide many advantages but also entail risks inherent to internet transactions. We cannot guarantee that a person ordering a child's photo has the legal right to receive it. Actual or perceived failure to comply with such laws could lead to significant reputational damage, enforcement actions, penalties and expenses. Additionally, the evolving regulatory environment for student data privacy may make it more difficult for Lifetouch to obtain the data from schools that it requires to conduct an efficient Picture Day, which may result in higher costs and inefficiencies. Increasing compliance and contracting requirements means increasing exposure to liability for breach and rising cost of doing business.

If a change in privacy laws requires Lifetouch to obtain prior express parental consent to photograph children in schools, or if inclusion in a school yearbook requires express parental consent, participation rates may decline. Additionally, if systems failure or human error results in failed delivery or unauthorized access to our images, it could result in harm to our reputation and/or customer and account loss. In either of these instances, our financial results would likely suffer.

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

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

As of December 31, 2018, Shutterfly and Lifetouch had 143 patents issued and more than 30 patent applications pending in the United States. We intend to pursue corresponding patent coverage in other countries to the extent we believe such coverage is appropriate and cost efficient. We cannot ensure that any of our pending applications will be granted. In addition, third parties have in the past and could in the future bring infringement, invalidity, co-inventorship or similar claims with respect to any of our currently issued patents or any patents that may be issued to us in the future. Any such claims, whether or not successful, could be extremely costly to defend, divert management's time and attention, damage our reputation and brands and substantially harm our business and results of operations.

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

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

We respond on a case-by-case basis and where appropriate may send cease and desist letters or commence opposition actions and litigation. However, we cannot ensure that the steps we have taken to protect our intellectual property rights are adequate, that our intellectual property rights can be successfully defended and asserted in the future or that third parties will not infringe upon or misappropriate any such rights. In addition, our trademark rights and related registrations may be challenged in the future and could be canceled or narrowed. Failure to protect our trademark rights could prevent us in the future from challenging third parties who use

names and logos similar to our trademarks, which may in turn cause consumer confusion or negatively affect consumers' perception of our brands, products, and services. Any claims or consumer confusion related to our trademarks could damage our reputation and brands and substantially harm our business and results of operations.

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

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

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

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

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

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

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

- The Children’s Online Protection Act and the Children’s Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children from Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.
- The Credit Card Accountability, Responsibility and Disclosure Act (CARD Act) is intended to protect consumers from unfair credit card billing practices and adds new regulations on the use of gift cards, limiting our ability to expire them. Several states are attempting to pass new laws regulating the use of gift cards and amending state escheatment laws to try to pass new laws regulating the use of gift cards and amending state escheatment laws to try and obtain unused gift card balances.
- The Restore Online Shoppers’ Confidence Act (ROSCA) prohibits and prevents Internet-based post-transaction third-party sales and imposes specific requirements on negative option features.
- The Personal Information Protection and Electronic Documents Act of 2000 (PIPEDA) and substantially similar provincial laws in Canada govern how private sector organizations collect, use and disclose personal information in the course of commercial activities.
- The California Consumer Privacy Act of 2018 (CCPA), which will come into effect on January 1, 2020, requires companies that process information on California residents to make new disclosures to consumers about their data collection, use and sharing practices, allows consumers to opt out of certain data sharing with third parties and provides a new cause of action for data breaches. The burdens imposed by the CCPA and other similar laws that may be enacted at the federal and state level may require us to modify our data processing practices and policies and how we advertise to our users and to incur substantial expenditure in order to comply.
- The Illinois Biometric Information Privacy Act (IBIPA) regulates the collection, use, safeguarding, and storage of “biometric identifiers” or “biometric information” by private entities. While the statute specifically excludes photographs from its scope, to date there has been no dispositive judicial interpretation of that language.

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

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

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

Lifetouch often contracts with schools to provide spring portraits that feature a variety of looks and media different from the traditional fall headshot and that offer schools an opportunity for fundraising. In some markets, Lifetouch offers spring portraits under a "Family Approval" model whereby portrait products are distributed by the school to parents for review. Parents are asked to pay for the products they elect to keep (if any) and to return any products they do not wish to purchase to the school. Lifetouch has been and, in the future, may be subject to claims from individuals that these products qualify as "gifts" and/or that the program does not comply with legislation pertaining to "unsolicited goods." While we do not believe that such legislation is applicable to school photography, if Lifetouch becomes subject to such claims and is required or elect to curtail the use of the Family Approval model, its business and revenue may be negatively impacted.

Our marketing practices could be subject to judicial or regulatory challenge.

We regularly offer free products, free shipping or free trials as an inducement for customers to try our products or as part of other promotional photographic programs. Although we believe that we conspicuously and clearly communicate all details and conditions of these offers, for example, that customers are required to pay shipping, handling and/or processing charges to take advantage of a free product offer or that for our spring school photo day, families must return payments along with any prints they do not want under our "family approval model", we have been and, in the future, may be subject to claims from individuals or governmental regulators that our offers are misleading or do not comply with applicable legislation. These claims may be expensive to defend and could divert management's time and attention. If we become subject to such claims in the future or are required or elect to curtail or eliminate our use of free offers, our business and results of operations may be harmed.

We may be subject to product liability claims if people or property are harmed by the products we sell.

Some of the products we sell may expose us to product liability claims relating to issues such as personal injury, death, or property damage, and may require product recalls or other actions. Any claims, litigation, or recalls relating to product liability could be costly to us and damage our brands and reputation.

The failure of our suppliers and manufacturing fulfillers to use legal and ethical business practices could negatively impact our business.

We source the raw materials for the products we sell from an expanding number of suppliers in an increasing number of jurisdictions worldwide, and we contract with third-party manufacturers to fulfill customer orders. Although we require our suppliers and fulfillers to operate in compliance with all applicable laws, including those regarding corruption, working conditions, employment practices, safety and health, and environmental compliance, we cannot control their business practices, and we may not be able to adequately vet, monitor, and audit our many suppliers and fulfillers (or their suppliers) throughout the world. If any of them violates labor, environmental, or other laws or implements business practices that are regarded as unethical, our reputation could be severely damaged, and our supply chain and order fulfillment process could be interrupted, which could harm our sales and results of operations.

We are subject to safety, health, and environmental laws and regulations, which could result in liabilities, cost increases or restrictions on our operations.

We are subject to a variety of safety, health and environmental laws and regulations in each of the jurisdictions in which we operate. These laws and regulations govern, among other things, air emissions, wastewater discharges, the storage, handling and disposal of hazardous and other regulated substances and wastes, soil and groundwater contamination and employee health and safety. We use regulated substances such as inks and solvents and generate air emissions and other discharges at our manufacturing facilities, and some of our facilities are required to hold environmental permits. If we fail to comply with existing safety, health and environmental laws and regulations, or new, more stringent safety, health and environmental laws and regulations applicable to us are imposed, we may be subject to monetary fines, civil or criminal sanctions, third-party claims, or the limitation or suspension of our operations. In addition, if we are found to be responsible for hazardous substances at any location (including, for example, offsite waste disposal facilities or facilities at which we formerly operated), we may be responsible for the cost of cleaning up contamination, regardless of fault, as well as to claims for harm to health or property or for natural resource damages arising out of

contamination or exposure to hazardous substances.

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

The digital photography industry is rapidly evolving. Professional photography and the tradition of school pictures is subject to continuing disruption from the changes in digital photography and commerce. Changing technologies, intense price competition, additional competitors, evolving industry standards, frequent new service and platform announcements and changing consumer demands and behaviors, including an ongoing trend toward increased video consumption, all impact our business. To the extent that consumer adoption of digital photography does not continue to grow as expected, our revenue growth would likely suffer. A shift in consumer demands toward video would also require additional network infrastructure, including data storage, to continue to satisfy the needs of our customers. Moreover, we face significant risks that, if the industry for digital photography evolves in ways that we are not able to address due to changing technologies or consumer behaviors, pricing pressures, or otherwise, we may find it difficult to create products to accommodate such an evolution or our current products and services may become less attractive, which would result in the loss of customers, as well as lower net revenue and/or increased expenses.

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

The online industry for digital photography products and services, including photographic and video equipment rentals, is less developed than the online industry for other consumer products. With the acquisition of Lifetouch, our delivery of photographic products is greatly increased. Our success, and a key synergy anticipated from the acquisition of Lifetouch, will depend in part on our ability to acquire customers who historically have used traditional retail photography services or who have produced photographs and other products using self-service alternatives, such as printing at home. Furthermore, we may have to incur significantly higher and more sustained advertising and promotional expenditures or reduce the prices of our products and services to acquire additional online consumers to our websites and convert them into purchasing customers. Specific factors that could prevent prospective customers from purchasing from us include:

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

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

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

It is possible that we may discover significant deficiencies or material weaknesses in our internal control over financial reporting in the future. This risk is heightened during the period in which we are integrating Lifetouch, which has not previously been subject to the heightened control standards of a public company. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could cause us to fail to meet our periodic reporting obligations, or result in material misstatements in our financial information. We use numerous third-party licensed software packages, most notably our equity software, leasing software and our SBS resource planning software, which are complex and fully integrated into our financial reporting. Such third-party software may contain errors that we may not identify in a timely manner. If those errors are not identified and addressed timely, our financial reporting may not be in compliance with generally accepted

accounting principles. Any such delays, errors or restatements could cause investors to lose confidence in our reported financial information and lead to a decline in our stock price.

Actions of activist stockholders could cause us to incur substantial costs, divert management's attention and resources, and have an adverse effect on our business.

From time to time, we may be subject to proposals by stockholders urging us to take certain corporate actions. If activist stockholder activities ensue, our business could be adversely affected because responding to proxy contests and reacting to other actions by activist stockholders can be costly and time-consuming, disrupt our operations and divert the attention of management and our employees. For example, we may be required to retain the services of various professionals to advise us on activist stockholder matters, including legal, financial and communications advisors, the costs of which may negatively impact our future financial results. In addition, perceived uncertainties as to our future direction, strategy or leadership created as a consequence of activist stockholder initiatives may result in the loss of potential business opportunities, harm our ability to attract new investors, customers, employee, and business partners, and cause our stock price to experience periods of volatility or stagnation.

Maintaining and improving our financial controls and the requirements of being a public company may strain our resources and divert management's attention.

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

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

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

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

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

Additionally, in December 2017, the current U.S. administration signed an act referred to as the "Tax Cuts and Jobs Act" (the "TCJA"), generally effective for taxable years beginning after December 31, 2017. The TCJA is complex and includes significant amendments to the Internal Revenue Code of 1986, as amended (the "Code"), including amendments that significantly change the taxation of offshore earnings and the deductibility of interest. Compliance with the TCJA and the accounting for such provisions require accumulation of information not previously required or regularly produced. As a result, we have provided a provisional estimate on the effect of the TCJA in our financial statements. As additional regulatory guidance is issued by the applicable taxing authorities, as accounting treatment is clarified, as we perform additional analysis on the application of the law, and as we refine estimates in calculating the effect, our final analysis, which will be recorded in the period completed, may be different from our current

provisional amounts, which could materially affect our tax obligations and effective tax rate.

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

A key component of our business strategy includes strengthening our competitive position and refining the customer experience on our websites and mobile applications through internal development. However, from time to time, we may selectively pursue acquisitions of complementary businesses. The identification of suitable acquisition candidates can be time-consuming and expensive, and we may not be able to successfully complete identified acquisitions. Furthermore, even if we successfully complete an acquisition, we may not achieve the anticipated benefits and synergies we expect due to a number of factors including the loss of management focus on and the diversion of resources from existing businesses; difficulty retaining key personnel of the acquired company; cultural challenges associated with integrating employees from an acquired company into our organization; difficulty integrating acquired technologies into our existing systems; entry into a business or industry with which we have historically had little experience; difficulty and increased costs of integrating data systems; the need to implement or remediate the controls, procedures or policies of the acquired company; and increased risk of litigation. While we have actively sought to control increases in costs that may stem from such acquisitions, there can be no assurance that we will succeed in limiting future cost increases. Failure to achieve the anticipated benefits of such acquisitions or the incurrence of debt, contingent liabilities, amortization expenses, or write-offs of goodwill in connection with such acquisitions could harm our operating results.

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

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

We are subject to the risks of owning real property.

We own real property as of the acquisition of Lifetouch, including the land and buildings at ten of the Lifetouch facilities. The ownership of real property subjects us to risks, including: the possibility of environmental contamination and the costs associated with fixing any environmental problems and the risk of damages resulting from such contamination; adverse changes in the value of the property due to interest rate changes, changes in the neighborhood in which the property is located or other factors; ongoing maintenance expenses and costs of improvements; the possible need for structural improvements in order to comply with zoning, seismic, disability act or other requirements; and possible disputes with neighboring owners or others.

Risks Related to Our Common Stock

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

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

- failure to realize the anticipated benefits from the Lifetouch acquisition;

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

Provisions of our restated certificate of incorporation and restated bylaws and Delaware law may deter third parties from acquiring us. Our restated certificate of incorporation and restated bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

- our board is classified into three classes of directors, each with staggered three-year terms;
- only our chairman, our president and chief executive officer or a majority of our board of directors are authorized to call a special meeting of stockholders;
- our stockholders may take action only at a meeting of stockholders and not by written consent;
- vacancies on our board of directors may be filled only by our board of directors and not by stockholders;
- our certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

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

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

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

In April of 2017, our board of directors approved an increase to the share repurchase program of up to $140.0 million in addition to amounts remaining under the board's prior authorizations. Through December 31, 2018, we have repurchased $533.2 million in stock under our total authorized amount of $646.0 million. In January 2018, we publicly announced that we had suspended our stock repurchase program, which we expect to reinstate in the fourth quarter of 2019. The stock repurchase program may be recontinued or discontinued at any time without prior notice. In the event that we recontinue our stock repurchase program, future repurchases pursuant to our stock repurchase program could affect the price of our common stock and increase its volatility. The existence of our stock repurchase program could also cause the price of our common stock to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our common stock. Additionally, repurchases under our stock repurchase program will diminish our cash reserves, which could impact our ability to further develop our technology, access and/or retrofit additional facilities and service our indebtedness. There can be no assurance that any stock repurchases will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased such shares. Any failure to repurchase shares after we have announced our intention to do so may negatively impact our reputation and investor confidence in us and may negatively impact our stock price. Although our stock repurchase program is intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the program's effectiveness.

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

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

Risks Related to Our Credit Agreement

Our indebtedness could adversely affect our financial condition and our ability to raise additional capital to fund our operations and limit our ability to react to changes in the economy or our industry.

On April 2, 2018, in connection with our acquisition of Lifetouch, we incurred substantial indebtedness pursuant to an incremental term loan facility (the "Incremental Term Loan Facility") in an aggregate principal amount of $825.0 million. The incremental term loan facility is an amendment of our initial term loan facility of $300.0 million dated as of August 17, 2017 (collectively, the "Credit Agreement"). The Incremental Term Loan Facility was fully funded at close. The Credit Agreement will mature on August 17, 2024 and requires quarterly principal payments, as well as mandatory prepayments due to assets sales or excess cash flow, with the balance payable at maturity.

Our substantial indebtedness could have important consequences to us including:

- increasing our vulnerability to adverse general economic and industry conditions;
- requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, execution of our business strategy, acquisitions and other general corporate purposes;
- limiting our flexibility in planning for, or reacting to, changes in the economy and our industry;
- our ability to refinance our debt;
- exposing us to interest rate risk to the extent of our variable rate indebtedness; and
- making it more difficult to borrow additional funds in the future to fund growth, acquisitions, working capital, capital expenditures and other purposes.

The Credit Agreement contains customary events of default upon the occurrence of which, after any

applicable grace period, the lenders would have the ability to immediately declare the loans due and payable in whole or in part. In such event, we may not have sufficient available cash to repay such debt at the time it becomes due or be able to refinance such debt on acceptable terms or at all. Any of the foregoing could materially and adversely affect our financial condition and results of operations.

We receive debt ratings from the major credit rating agencies in the United States. Factors that may impact our credit ratings include debt levels, leverage ratios, planned asset purchases or sales and near-term and long-term production growth opportunities. Liquidity, asset quality, cost structure, reserve mix and commodity pricing levels could also be considered by the rating agencies. A ratings downgrade could adversely impact our ability to access debt markets in the future and increase the cost of current or future debt and may adversely affect our share price.

Our Credit Agreement imposes restrictions on our business.

The Credit Agreement contains several covenants imposing restrictions on our business. These restrictions may affect our ability to operate our business and may limit our ability to take advantage of potential business opportunities as they arise. The restrictions, among other things, restrict our ability to create or incur certain liens, incur or guarantee additional indebtedness, merge or consolidate with other companies, payment of dividends, transfer or sell assets and make restricted payments. These restrictions are subject to several limitations and exceptions set forth in the Credit Agreement. Our ability to meet the liquidity covenant may be affected by events beyond our control.

The foregoing restrictions could limit our ability to plan for, or react to, changes in market conditions or our capital needs. We do not know whether we will be granted waivers under, or amendments to, our Credit Agreement if for any reason we are unable to meet these requirements, or whether we will be able to refinance our indebtedness on terms acceptable to us, or at all.

Servicing our debt requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt.

Our ability to make scheduled payments of the principal of, to pay interest on, and to refinance our debt, depends on our future performance, which is subject to financial, competitive, economic, and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to make necessary capital expenditures or to satisfy our obligations under the Credit Agreement and any future indebtedness that we may incur. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. We may not be able to engage in any of these activities or engage in these activities on desirable terms when needed, which could result in a default on our indebtedness.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2. PROPERTIES.

Our properties consist primarily of owned and leased office facilities for manufacturing, warehousing, customer service, portrait studio, technical development and administrative personnel. The table below includes material owned property, property leases, including both operating and build-to-suit arrangements.

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

LOCATION	PRINCIPAL USE	SQUARE FOOTAGE	LEASE TERM
Redwood City, California	Corporate headquarters	100,000	2022
Fort Mill, South Carolina(1)	Manufacturing and customer service facility for Shutterfly Consumer and SBS segments	300,000	2023
Eden Prairie, Minnesota	Principal office for Lifetouch segment	289,000	owned
Shakopee, Minnesota(2)	Manufacturing and customer service facility for all segments	217,000	2024
Tempe, Arizona(3)	Manufacturing and customer service facility for Shutterfly Consumer and SBS segments	237,000	2025
Burnsville, Minnesota(4)	Warehousing and administrative facility for Lifetouch segment	100,000	2025
Bloomington, Minnesota(5)	Manufacturing and administrative facility for Lifetouch segment	90,000	owned
Chattanooga, Tennessee(5)	Manufacturing, warehousing and administrative facility for Lifetouch segment	78,000	owned
Chesapeake, Virginia	Manufacturing, warehousing and administrative facility for Lifetouch segment	60,000	owned
Loves Park, Illinois(5)	Manufacturing, warehousing and administrative facility for Lifetouch segment	60,000	owned
Chico, California(5)	Manufacturing and administrative facility for Lifetouch segment	53,000	owned
Galion, Ohio	Manufacturing, warehousing and administrative facility for Lifetouch segment	79,000	owned
Reno, Nevada	Manufacturing and administrative facility for Lifetouch segment	35,000	owned

(1) We have the option to expand the facility by an additional 100,000 square feet as well as an option to extend the lease for one additional period of five years.

(2) We have an option to extend the lease for three additional periods of five years.

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

(4) We assumed the lease for this facility in connection with our acquisition of Lifetouch in the second quarter of 2018.

(5) During the fourth quarter of 2018, the Company's Board of Directors approved a restructuring plan to close four Lifetouch facilities in 2019: Loves Park, Illinois; Bloomington, Minnesota; Chico, California; and Chattanooga, Tennessee and consolidate this volume into existing Shutterfly facilities and a new 237,000 square foot facility in Texas to be completed in the first half of 2020.

ITEM 3. LEGAL PROCEEDINGS

We are subject to the various legal proceedings and claims discussed below as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business. Although adverse decisions (or settlements) may occur in one or more of these proceedings, it is not possible to estimate the possible loss or losses from each of these proceedings. The final resolution of these proceedings, individually or in the aggregate, is not expected to have a material adverse effect on our business, financial position or results of operations. Cases that previously were disclosed may no longer be described because of rulings in the case, settlements, changes in our business or other developments rendering them, in our judgment, no longer material to our business, financial position or results of operations. One material legal proceeding was terminated during the third quarter of 2018.

Monroy v. Shutterfly, Inc.

On November 30, 2016, Alejandro Monroy on behalf of himself and all others similarly situated, filed a complaint against Shutterfly in the U.S. District Court for the Northern District of Illinois. The complaint asserts that Shutterfly violated the Illinois Biometric Information Privacy Act by extracting his and others' biometric identifiers from photographs and seeks statutory damages and an injunction. We believe the suit is without merit and intend to vigorously defend against it.

Taylor v. Shutterfly, Inc.

On December 12, 2017, Megan Taylor filed a purported class action complaint on behalf of herself and other customers in the U.S. District Court for the Northern District of California. Taylor alleges that Shutterfly misrepresents a deal it currently offers through Groupon because it does not allow purchasers of the Groupon offer to combine or "stack" it with other promotional codes offered by Shutterfly. Taylor is seeking monetary damages and injunctive relief. We believe the suit is without merit and intend to vigorously defend against it.

Vigeant v Meek et al.

On March 1, 2018, a purported class action complaint was filed against several directors of Lifetouch, Inc. (which became a direct wholly-owned subsidiary of Shutterfly on April 2, 2018) and the trustee of the Lifetouch Employee Stock Ownership Plan (the "ESOP") in the U.S. District Court for the District of Minnesota (the "District Court"). On April 2, 2018, the complaint was amended to include the prior ESOP trustees and plan sponsor (Lifetouch) as additional named defendants. On November 7, 2018, the District Court granted defendant's motion to dismiss in its entirety and with prejudice. Plaintiffs' counsel filed a timely notice of appeal with the 8th Circuit Court of Appeals. The complaint alleges violations of the Employee Retirement Income Security Act, including that the ESOP should not have been permitted to continue investing in Lifetouch stock during a period in which the Lifetouch stock price was declining. The plaintiffs seek recovery for damages arising from the alleged breaches of fiduciary duty. We believe this suit is without merit and intend to vigorously defend against it.

In all cases, at each reporting period, we evaluate whether a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses accounting for contingencies. In such cases, we accrue for the amount, or if a range, we accrue the low end of the range as a component of legal expense. We monitor developments in these legal matters that could affect the estimate we had previously accrued. There are no amounts accrued that we believe would be material to our financial position, liquidity, and results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

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

Shutterfly's common stock is traded on The Nasdaq Global Select Market under the symbol "SFLY." As of February 25, 2019, there were approximately 64 stockholders of record, excluding stockholders whose shares were held in nominee or street name by brokers. We have never paid cash dividends on our capital stock and we do not anticipate paying any cash dividends in the foreseeable future.

Issuer Purchases of Equity Securities

We suspended our share repurchase program as of December 31, 2017. On February 5, 2018, we announced that we expect to begin executing on a capital return plan during the fourth quarter of 2019.

ITEM 6. SELECTED FINANCIAL DATA.

The consolidated statements of operations data for the years ended December 31, 2018, 2017 and 2016 and the consolidated balance sheet data as of December 31, 2018 and 2017 have been derived from our audited consolidated financial statements included elsewhere in this annual report on Form 10-K. The consolidated statements of operations data for the year ended December 31, 2015 and 2014 and the consolidated balance sheet data as of December 31, 2016, 2015 and 2014 have been derived from our audited consolidated financial statements not included in this annual report on Form 10-K. The following selected consolidated financial data should be read in conjunction with our "Management's Discussion and Analysis of Financial Condition and Results of Operations" and consolidated financial statements and related notes to those statements included elsewhere in this annual report on Form 10-K.

	YEAR ENDED DECEMBER 31,				
	2018(1)	2017	2016	2015	2014
	(in thousands, except per share amounts)				
CONSOLIDATED OPERATIONS STATEMENT DATA:					
Net revenue	$ 1,961,820	$1,190,202	$1,134,224	$1,059,429	$ 921,580
Cost of net revenue	961,575	619,650	566,117	528,078	452,720
Restructuring	—	1,475	—	—	—
GROSS PROFIT	**1,000,245**	**569,077**	**568,107**	**531,351**	**468,860**
Operating expenses:					
Technology and development	177,001	168,383	166,909	155,318	133,623
Sales and marketing	505,833	197,708	233,585	236,749	216,035
General and administrative	197,340	117,797	118,503	121,019	112,957
Capital lease termination	—	8,098	—	—	—
Restructuring	4,618	15,491	—	—	—
TOTAL OPERATING EXPENSES	**884,792**	**507,477**	**518,997**	**513,086**	**462,615**
Income from operations	115,453	61,600	49,110	18,265	6,245
Interest expense	(61,239)	(27,836)	(23,023)	(20,998)	(16,732)
Interest and other income, net	5,444	1,481	501	744	508
INCOME (LOSS) BEFORE INCOME TAXES	**59,658**	**35,245**	**26,588**	**(1,989)**	**(9,979)**
(Provision for) benefit from income taxes	(9,262)	(5,160)	(10,682)	1,146	2,119
NET INCOME (LOSS)	**$ 50,396**	**$ 30,085**	**$ 15,906**	**$ (843)**	**$ (7,860)**
Net income (loss) per share:					
Basic	$ 1.52	$ 0.91	$ 0.47	$ (0.02)	$ (0.20)
DILUTED	**$ 1.45**	**$ 0.88**	**$ 0.45**	**$ (0.02)**	**$ (0.20)**
Weighted average shares:					
Basic	33,258	33,113	34,097	36,761	38,452
Diluted	34,832	34,106	35,190	36,761	38,452

(1) Results of Lifetouch are included in the consolidated statement of operations from the date of its acquisition in the second quarter of 2018.

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

	YEAR ENDED DECEMBER 31,				
	2018	2017	2016	2015	2014
	(in thousands)				
Cost of net revenue	$ 3,824	$ 4,339	$ 4,579	$ 4,134	$ 3,657
Technology and development	9,990	9,778	8,550	10,840	9,236
Sales and marketing	12,790	12,229	15,445	21,512	22,670
General and administration	21,117	17,227	17,118	23,972	26,199
Restructuring	—	814	—	—	—

The chart below includes selected data from our balance sheets:

	DECEMBER 31,				
	2018	2017	2016	2015	2014
	(in thousands)				
CONSOLIDATED BALANCE SHEET DATA:					
Cash, cash equivalents, and investments	$ 566,386	$ 677,157	$ 330,055	$ 340,786	$ 475,337
Property and equipment, net	381,018	266,860	284,110	281,779	241,742
Working capital	324,203	230,210	212,188	200,505	350,925
Total assets	2,302,209	1,534,800	1,195,576	1,205,327	1,327,774
Current portion of long-term debt	14,203	297,054	—	—	—
Long-term debt	1,090,442	292,457	278,792	264,361	250,714
Other long-term liabilities	134,027	119,195	137,035	123,112	122,268
Total stockholders' equity	674,366	550,724	559,161	606,062	757,806

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

The following discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements, the accompanying notes, and other information included elsewhere in this Annual Report on Form 10-K. In particular, the disclosure contained in Item 1A of this Annual Report may reflect trends, demands, commitments, events, or uncertainties that could materially impact our results of operations and liquidity and capital resources.

The following discussion contains forward-looking statements, such as statements regarding our future operating results and financial position, our business strategy and plans, our trends, and our objectives for future operations. Please see "Note About Forward-Looking Statements" for more information about relying on these forward-looking statements.

Historically, we have reported two reportable segments. In conjunction with the acquisition of Lifetouch, Inc. on April 2, 2018, we expanded our reporting segments. We are now managed through three reportable segments, (i) Shutterfly Consumer, (ii) Lifetouch and (iii) Shutterfly Business Solutions.

Overview

We are the leading retailer and manufacturing platform for personalized products and communications. Founded and incorporated in the state of Delaware in 1999, Shutterfly has three reportable segments: Shutterfly Consumer, Lifetouch, and Shutterfly Business Solutions ("SBS"). Shutterfly Consumer and Lifetouch help consumers capture, preserve, and share life's important moments through professional and personal photography, and personalized products. The Shutterfly brand brings photos to life in photo books, gifts, home décor, and cards and stationery. Lifetouch is the national leader in school photography, built on the enduring tradition of "Picture Day," and also serves families through portrait studios and other partnerships. SBS delivers digital printing services that enable efficient and effective customer engagement through personalized communications. We are headquartered in Redwood City, California.

On April 2, 2018, we completed the acquisition of Lifetouch Inc. ("Lifetouch"). We are bringing Shutterfly's strengths as the leader in personalized photo-based products coupled with photo storage, together with Lifetouch's strengths as the leader in school and family photography, to create the only end-to-end memory solution for families. As a result of the acquisition, we have a new reportable segment for the Lifetouch business (refer to Note 15—*Segment Reporting* for further details).

In 2018, revenue increased 65% year over year to approximately $2.0 billion. This increase was driven by the acquisition of Lifetouch which contributed $759.4 million and by a 19% increase in revenue from our SBS segment which contributed $230.6 million, while revenue from our Shutterfly Consumer segment decreased by $25.1 million year over year to $971.8 million. While our revenue results in 2018 were mixed, we had several successes due to our focus on long-term strategic priorities and investments in consumer facing programs and infrastructure projects that will provide future scale and scope efficiencies. These initiatives included the following:

- We continue to simplify the process of creating and purchasing personalized products. We launched a new shopping cart experience, offering interoperability between using a desktop browser and our mobile app. The new Cart significantly improves the speed of checkout and is far more scalable to our peak needs. We've also simplified how we present our pricing to customers, making it easier to understand the discount they'll receive at every stage of the purchase path and reducing the need to enter discount codes.
- We saw solid performance in Personalized Gifts and Home Décor, which delivered a significant re-acceleration of growth as a result of the faster rate of new product introductions with 47 new products in 2018, double the number launched in 2017. In Cards & Stationery, several of the new features and formats we launched in 2018 resonated with customers this holiday season, including personalized foil which is a printing innovation that allows for a wide range of premium flexible designs using elegant metallic foil. Our Holiday card range included 1,400 designs in 2018; 800 for Shutterfly and 600 for Tiny Prints, with more than 75% of card designs being new.
- During the third quarter of 2018, we introduced two new categories on Shutterfly.com: Kids and Pets. These two categories are targeted to children and pet lovers who love to personalize their belongings and make a statement. The

products offer range from kids' room décor to school supplies and pet accessories such as bandanas, ID tags and pet blankets. The Kids category also includes a new line of personalized children's storybooks with licensed content from Nickelodeon.

- In 2018, we continued to make improvements to our mobile app focusing on adding more products to the app, launching more than 60 new products, including a new app-exclusive program called Free-Book-A-Month, improving and simplifying in-app creation, and enhancing the shopping experience and navigation.
- We also offer Shutterfly Photos, our cloud photo management service, to our customers. During fall picture day season in 2018, Lifetouch school customers who purchased digital images from mylifetouch.com were able to access these pictures directly within Shutterfly Photos. These customers benefited from free storage for any personal photos they uploaded as well as their Lifetouch photos, and were able to create and purchase personalized products using these photos. Our experience shows that integrating customers' photos onto Shutterfly Photos is the best way to drive customer engagement and purchases of our products. This initial phase technology integration is our first step in reaching a small set of customers; we expect modest revenue synergies for these activities in 2019, but are working towards deeper integration and larger revenue synergies in 2019 and beyond.
- SBS continued to expand as a business in 2018, with strong growth, demonstrating our ability to focus on execution and serving our large existing clients.

Basis of Presentation

Net Revenue. Our net revenue is comprised of sales generated from Shutterfly Consumer, Lifetouch and SBS segments.

Shutterfly Consumer. Our Shutterfly Consumer revenue includes sales from our brands and are derived from the sale of a variety of products such as, cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and prints, and the related shipping revenue as well as rental revenue from our BorrowLenses brand. Revenue from advertising displayed on our websites is also included in Shutterfly Consumer revenue.

Lifetouch. Our Lifetouch revenue is primarily from professional photography services for schools, preschools and retail studios operated by Lifetouch under the JCPenney Portrait brand as well as Churches and other groups.

SBS. Our SBS revenue is primarily from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for our business customers. We continue to focus our efforts in expanding our presence in this industry.

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

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

Total Customers. We closely monitor total customers as a key indicator of demand. Total customers represent the number of transacting customers in a given period. An active customer is defined as one that has transacted in the last trailing twelve months. We seek to expand our customer base by empowering our existing customers with sharing and collaboration services, and by conducting integrated marketing and advertising programs. We also acquire new customers through customer list acquisitions.

Total Number of Orders. We closely monitor total number of orders as a leading indicator of net revenue trends. We recognize net revenue associated with an order when the products have been shipped and all other revenue recognition criteria have been met. Orders are typically processed and shipped in approximately three business days after a customer places an order.

Average Order Value. Average order value ("AOV") is Shutterfly Consumer net revenue for a given period divided by the total number

of customer orders recorded during that same period. AOV is impacted by product sales mix and pricing and promotional strategies, including our promotions and competitor promotional activity. As a result, our AOV may fluctuate on a quarterly and annual basis.

Our Lifetouch segment is also subject to seasonal fluctuations. In particular, we generate a substantial portion of our Lifetouch segment revenue in the fourth quarter during the traditional fall school and holiday portraits season. The Lifetouch segment also typically experiences increases in net revenue during the second quarter due to the spring school portrait and yearbook seasons.

Our SBS segment revenue is generated from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for our business customers.

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

Cost of Net Revenue. Our cost of net revenue is split between our Shutterfly Consumer, Lifetouch and SBS segments.

Shutterfly Consumer. Cost of net revenue for the Shutterfly Consumer segment consists of costs incurred to produce personalized products for all our brands. These costs include direct materials (the majority of which consists of paper, ink, and photo book covers), shipping charges, packing supplies, distribution and fulfillment activities, third-party costs for photo-based merchandise, payroll and related expenses for direct labor and customer service, rent for production facilities, and depreciation of production equipment (primarily digital printing presses and binders) and manufacturing facilities. Cost of net revenue also includes amortization of capitalized website and software development costs, primarily related to adding features and functionality to our website and apps to facilitate product purchases and improve the customer shopping experience. These costs include amortization of third-party software and acquired developed technology as well as patent royalties. Cost of net revenue also includes inventory markdowns that are part of restructuring activities.

Lifetouch. Cost of net revenue for the Lifetouch segment consists of costs incurred to capture and produce photography products. These costs include direct materials (the majority of which consists of paper, ink, and yearbook covers), shipping charges, packing supplies, distribution and fulfillment activities, payroll and related expenses for direct labor (including photographers) and customer service, and depreciation of production and photography equipment and manufacturing facilities. Cost of net revenue also includes amortization of capitalized website and software development costs, primarily related to adding features and functionality to the Lifetouch website to facilitate product purchases and improve the customer shopping experience. These costs include amortization of third-party software and acquired developed technology.

SBS. Cost of net revenue for the SBS segment consists of costs which are direct and incremental to the SBS business. These include production costs of SBS products, such as materials, labor and printing costs, shipping costs, indirect overhead and depreciation as well as costs associated with third-party production of goods.

Operating Expenses. Operating expenses consist of technology and development, sales and marketing, general and administrative and restructuring expenses.

Technology and development expense consists primarily of salaries and benefits for employees and professional fees for contractors engaged in the maintenance and support of our website, developing features and functionality for our free photo storage service, and developing and maintaining internal infrastructure, internal reporting tools and network security and data encryption systems. These expenses include depreciation of computer and network hardware used to run our websites, store user photos and related data, and support our infrastructure, as well as amortization of software used to operate such hardware. Technology and development expense also includes co-location, power and bandwidth costs.

Sales and marketing expense consists of costs incurred for marketing programs, and personnel and related expenses for our customer

acquisition, product marketing, business development, and public relations activities. As it relates to the Lifetouch segment, sales and marketing expenses also consist of costs incurred to acquire host accounts (e.g., schools or churches) as well as the costs for marketing programs directed at the end-consumer. These costs include labor costs for sales professionals and account managers who maintain host relationships as well as the personnel and related expenses for product marketing activities. Our marketing efforts consist of various online and offline media programs, such as e-mail and direct mail promotions, flyers distributed by our hosts, social media and online display advertising, radio advertising, television advertising, the purchase of keyword search terms and various strategic alliances. We utilize these efforts to attract customers to our service.

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

Interest Expense. Interest expense consists of interest on our convertible senior notes arising from amortization of debt discount, amortization of debt issuance costs and our 0.25% coupon payment up until its settlement in May 2018, interest on our term loans issued in October 2017 and April 2018, costs associated with our syndicated credit facilities, and costs associated with our capital leases and build-to-suit arrangement financing obligations.

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

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

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of these consolidated 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. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation of our financial condition or results of operations will be affected.

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

Revenue Recognition. We derive our revenue from Shutterfly Consumer, Lifetouch and SBS product sales, net of applicable sales tax, collected from customers, which are remitted to governmental authorities. Revenue is recognized when control of the promised products or services is transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those products or services. Cash discounts are available to be used by customers at the time of purchase and are deducted from gross revenue in determining net revenue. Allowances for sales returns, which reduce revenue and cost of sales are estimated using historical experience. In arrangements with multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price. We generally determine stand-alone selling prices based on the prices charged to customers or

using expected cost plus a margin. Shipping charged to our customers is recognized as revenue upon shipment and the related shipping costs are recognized as cost of net revenue.

Shutterfly Consumer. Shutterfly Consumer revenue is primarily derived from the sale of products such as cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and prints, etc. Customers place Shutterfly Consumer product orders through the Shutterfly website or mobile apps and pay primarily using credit cards. The credit card payments are charged, and revenue is recognized upon shipment of the fulfilled orders, which generally occurs upon delivering to the carrier.

Lifetouch. The Lifetouch revenue is primarily derived from the sale of photographic and publishing products. Customers place Lifetouch product orders through the Lifetouch website, via paper order forms for school pictures, or in person at the JCPenney photo studios and churches. Customers pay using credit cards, or fill out an order form and enclose the required payment. We consider several indicators for the transfer of control to our customers, including the significant risks and rewards of ownership of products, our right to payment, the legal title of the products, the physical possession of the products and the customer acceptance. Revenue is generally recognized upon shipment of the fulfilled orders, which generally occurs upon delivery to the carrier or when fulfilled orders arrive at studio locations and are available for customer pickup, which is the point of time control transfers to the customer.

SBS. SBS revenue is derived from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for our business customers. The services that we promise to our SBS customers are typically composed of a series of services that are performed over time. We account for these series of services as one performance obligation which represents a series of distinct services that are substantially the same and have the same pattern of transfer. We recognize revenue from the satisfaction of performance obligations when we invoice our customers (that is, when we have the contractual right to bill under the contract). We have the contractual right to consideration from our customers in an amount that corresponds directly with the value to the customer of the services we have performed to date. For contracts that contain a significant non-refundable up-front fee, we consider whether these fees are related to the transfer of a promised good or service to the customer, and therefore represent a performance obligation. When the up-front fees do not represent a distinct performance obligation, we recognize revenue ratably over the period for which there is a significant termination contractual penalty.

We rely upon the following practical expedients and exemptions allowed for in the revenue recognition accounting standard. Our incremental direct costs of obtaining a contract consist of Lifetouch and SBS sales commissions. We do not defer such incremental direct costs as the related performance obligations are satisfied within a short period of time and we elected to apply the practical expedient per ASC 340-40-25-4 related to expensing contract acquisition costs with the amortization period of less than one year. We do not provide any financing services to our customers. In addition, we do not disclose the value of unsatisfied performance obligations for (a) contracts with an original expected length of one year or less and (b) contracts for which it recognizes revenues at the amount to which it has the right to invoice for services performed.

Valuation of Inventories. Our inventories consist primarily of paper, SBS materials, photo gifts, and packaging supplies and are stated at the lower of cost on a first-in, first-out basis or net realizable value. The value of inventories is reduced by an estimate for excess and obsolete inventories. The estimate for excess and obsolete inventories is based upon management's review of utilization of inventories in light of projected sales, current industry conditions and industry trends.

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

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

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in active markets

for similar assets or liabilities; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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

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

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

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

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

Income Taxes. We use the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized by applying the statutory tax rates in effect in the years in which the differences between the financial reporting and tax filing bases of existing assets and liabilities are expected to reverse. We have considered cumulative earnings and projected future earnings in assessing the need for a valuation allowance against our deferred tax assets. In 2018, our valuation allowance against certain California, South Carolina, and Arizona deferred tax assets increased to $18.9 million from $17.1 million in 2017. Based on our assessment, excluding the valuation allowance recorded related to certain Arizona, California and South Carolina deferred tax assets that are not likely to be realized, it is more likely than not that our U.S. net deferred tax asset will be realized through future taxable earnings, and/or the reversal of existing taxable temporary differences as of December 31, 2018. Accordingly, with exception of the valuation allowance discussed above, no additional valuation allowance has been recorded on net deferred tax assets as of December 31, 2018. Our business is cyclical and taxable income is highly dependent on revenue that historically has occurred during the fourth quarter. If there are changes to this historic trend and our fourth quarter does not yield results in-line with expectations, we may not be profitable in a given year resulting in a potential cumulative loss. If this were to occur, we would pursue any possible tax planning strategies that are feasible and prudent to avoid the expiration of our tax attributes. We will continue to assess the need for a valuation allowance in the future.

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

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

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

We estimate the fair value of stock options granted using the Black-Scholes valuation model. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of our common stock price using historical and implied volatility and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in our consolidated statements of operations.

The cost of RSUs and performance-based restricted stock units ("PBRSUs") is determined using the fair value of our common stock on the date of grant. Compensation expense is recognized for RSUs on a straight-line basis over the vesting period. Compensation expense associated with PBRSUs granted in previous years is recognized on an accelerated attribution model. As of December 31, 2018, the PBRSUs granted in previous years are only subject to service vesting conditions as the performance criteria has been met. In 2018, we granted PBRSUs that have both performance criteria tied to our 2020 financial performance and a three-year service condition. Compensation cost associated with these PBRSUs is recognized based on the estimated number of shares the Company ultimately expects will vest and amortized on a straight-line basis over the requisite service period as these PBRSUs consist of only one tranche.

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

Results of Operations

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

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
Net revenue	100%	100%	100%
Cost of net revenue	49	52	50
GROSS PROFIT	**51**	**48**	**50**
Operating expenses:			
Technology and development	9	14	15
Sales and marketing	26	17	21
General and administrative	10	10	10
Capital lease termination	—	1	—
Restructuring	—	1	—
TOTAL OPERATING EXPENSES	**45**	**43**	**46**
Income from operations	6	5	4
Interest expense	(3)	(2)	(2)
Interest and other income, net	—	—	—
INCOME BEFORE INCOME TAXES	**3**	**3**	**2**
Provision for income taxes	—	—	(1)
NET INCOME	**3%**	**3%**	**1%**

Comparison of the Years Ended December 31, 2018 and 2017

The following table presents the results of operations:

	YEAR ENDED DECEMBER 31,			
	2018	2017	$ CHANGE	% CHANGE
	(dollars in thousands)			
CONSOLIDATED				
Net revenue	$ 1,961,820	$1,190,202	$ 771,618	65 %
Cost of net revenue	961,575	619,650	341,925	55 %
Restructuring	—	1,475	(1,475)	(100)%
GROSS PROFIT	**1,000,245**	**569,077**	**431,168**	**76 %**
Gross margin	*51%*	*48%*		
Operating expenses:				
Technology and development	177,001	168,383	8,618	5 %
Sales and marketing	505,833	197,708	308,125	156 %
General and administrative[1]	197,340	117,797	79,543	68 %
Capital lease termination	—	8,098	(8,098)	(100)%
Restructuring	4,618	15,491	(10,873)	(70)%
TOTAL OPERATING EXPENSES	**884,792**	**507,477**	**377,315**	**74 %**
Income from operations	115,453	61,600	53,853	87 %
Interest expense	(61,239)	(27,836)	(33,403)	120 %
Interest and other income, net	5,444	1,481	3,963	268 %
INCOME BEFORE INCOME TAXES	**59,658**	**35,245**	**24,413**	**69 %**
Provision for income taxes	(9,262)	(5,160)	(4,102)	79 %
NET INCOME	**$ 50,396**	**$ 30,085**	**20,311**	**68 %**

[1] The general and administrative expenses of $197.3 million for year ended December 31, 2018 include $15.5 million in acquisition-related charges related to the acquisition of Lifetouch.

Net revenue

Net revenue increased $771.6 million, or 65%, in 2018 compared to 2017. Our Shutterfly Consumer, Lifetouch and SBS segments represented 49%, 39% and 12%, respectively, of total net revenue in 2018. The acquisition of Lifetouch contributed $759.4 million of the revenue growth in 2018. The remaining revenue growth was attributable to an increase in $37.3 million of revenue from the SBS segment, partially offset by revenue declines in the Shutterfly Consumer segment of $25.1 million, a 3% year-over-year decrease, as 3% organic Shutterfly Brand growth was offset by lost revenue from the brands and websites we shuttered in the 2017 platform consolidation and a year-over-year decline in the TinyPrints Boutique.

Cost of net revenue

Cost of net revenue increased $341.9 million, or 55%, in 2018 compared to 2017.

Excluding amortization of intangible assets, stock-based compensation expense and purchase accounting adjustments, our reportable segments contributed to the increase in cost of net revenue as follows:

- The Lifetouch segment contributed $310.4 million to the increase in cost of net revenue as we acquired Lifetouch during the second quarter of 2018;

- Cost of net revenue for our SBS segment increased $33.3 million primarily driven by the related increase in revenue; and
- Cost of net revenue for our Shutterfly Consumer segment decreased $4.4 million driven by the corresponding decrease in revenue.

Amortization of intangible assets expense for cost of net revenue increased $3.2 million and stock-based compensation expense decreased $0.5 million. The increase in amortization of intangible assets expense is due to amortization expense for the intangible assets we recorded in connection with the acquisition of Lifetouch of $6.6 million, partially offset by certain of our intangible assets that became fully amortized.

Gross margin increased to 51% in 2018 from 48% in 2017 primarily related to business mix as we acquired Lifetouch in April 2018 and Lifetouch has higher gross margins as compared to Shutterfly Consumer and SBS.

Technology and development

Our technology and development expense increased $8.6 million, or 5% in 2018, compared to 2017. As a percentage of net revenue, technology and development decreased to 9% in 2018 from 14% in 2017. Excluding amortization of intangible assets, stock-based compensation expense and integration costs, our reportable segments contributed to the increase in technology and development expense as follows:

- The Lifetouch segment contributed $21.7 million to the increase in technology and development expenses;
- Technology and development expenses for the Shutterfly Consumer segment decreased $16.0 million; and
- Technology and development expenses for the SBS segment decreased $4.3 million.

Due to the acquisition of Lifetouch, amortization of intangible assets expense for technology and development increased $3.7 million. Stock-based compensation expense increased $0.2 million and we also recorded $3.3 million in integration costs in technology and development expenses.

Sales and marketing

Our sales and marketing expense increased $308.1 million, or 156% in 2018, compared to 2017. As a percentage of net revenue, sales and marketing increased to 26% in 2018 from 17% in 2017. Excluding amortization of intangible assets, stock-based compensation expense and integration costs, our reportable segments contributed to the increase in sales and marketing as follows:

- The Lifetouch segment contributed $288.6 million to the increase in sales and marketing expenses;
- Sales and marketing expenses for the Shutterfly Consumer segment decreased $2.2 million; and
- Sales and marketing expenses for the SBS segment increased $1.6 million.

Amortization of intangible assets expense for sales and marketing increased $18.7 million due to amortization expense for the intangible assets we recorded in connection with the acquisition of Lifetouch of $24.2 million, partially offset by certain of our intangible assets that became fully amortized. Stock-based compensation expense increased $0.6 million and we also recorded $0.8 million in integration costs in sales and marketing expenses.

General and administrative

Our general and administrative expense increased $79.5 million, or 68%, in 2018, compared to 2017. As a percentage of net revenue, general and administrative expense remained flat at 10% in both 2018 and 2017. The acquisition of Lifetouch contributed $59.1 million to the increase in general and administrative expenses which primarily consists of salaries and benefits expenses and to a lesser extent, professional fees, facilities costs and credit card fees. During 2018 we recorded $15.5 million in acquisition-related charges in connection with the acquisition of Lifetouch and an increase in stock-based compensation expense of $3.9 million.

Capital lease termination

In 2017, there were $8.1 million in capital lease termination charges within operating expenses. These charges related to leased equipment from an existing vendor which we purchased and subsequently resold to HP during the second quarter of fiscal 2017.

Restructuring expense

In 2018, there were $4.6 million of restructuring charges within operating expenses in connection with the exit of Lifetouch's iMemories business and our planned exit of four facilities in 2019. Restructuring for the Lifetouch's iMemories business, which consists of $1.0 million in lease termination costs, $0.8 million in employee-

related costs and $1.2 million in other costs, was completed during the second quarter of 2018. The restructuring for the planned facilities exits consists of $0.9 million in employee related costs and $0.8 million in depreciation of property and equipment. The facilities exit will be completed in 2019.

In 2017, there were $15.5 million of restructuring charges within operating expenses. These restructuring charges primarily consist of $8.4 million in depreciation expense of disposed assets and facility closures, and $5.9 million in employee-related costs such as severance and retention expense, and $1.2 million related to other costs.

Interest expense

Interest expense was $61.2 million in 2018 compared to $27.8 million in 2017. This increase is primarily driven by interest expense for the initial term loan drawn in October 2017 and the incremental term loan drawn in April 2018 to finance the acquisition of Lifetouch. These increases are partially offset by decrease in interest expense for the convertible senior notes paid in May 2018.

Interest and other income, net

Interest and other income, net was $5.4 million in 2018 compared to $1.5 million in 2017. This increase is due to higher interest income resulting from higher cash equivalents and investment balances and higher interest rates.

Provision Income Taxes

We recorded an income tax provision of $9.3 million and $5.2 million in 2018 and 2017, respectively. Our effective tax rate was 16% in 2018, compared to 15% in 2017. Factors that impacted the effective tax rate include the federal research and development credit and limitations on executive compensation and the deduction of stock-based compensation.

Segment Information

We report our financial performance based on the following reportable segments: Shutterfly Consumer, Lifetouch and SBS. The segment amounts included in this section are presented on a basis consistent with our internal management reporting.

Additional information on our reportable segments is contained in Note 15—*Segment Reporting* of the Notes to the Financial Statements (Part II, Item 8 of this Annual Report on Form 10-K).

Shutterfly Consumer Segment

	YEAR ENDED DECEMBER 31,			
	2018	2017	$ CHANGE	% CHANGE
	(dollars in thousands)			
SHUTTERFLY CONSUMER				
Net revenue	$ 971,829	$ 996,963	$(25,134)	(3)%
Cost of net revenue(1)	452,226	456,665	(4,439)	(1)%
Technology and development(1)	124,670	140,698	(16,028)	(11)%
Sales and marketing(1)	168,442	170,687	(2,245)	(1)%
Credit card fees	25,072	25,645	(573)	(2)%
MARGIN	**$201,419**	**$203,268**	**$ (1,849)**	**(1)%**
Margin %	*21%*	*20%*		

(1) Excludes stock-based compensation expense and amortization of intangible assets.

	YEAR ENDED DECEMBER 31,			
	2018	2017	$ CHANGE	% CHANGE
	(figures in thousands, except AOV amounts)			
KEY CONSUMER METRICS				
Total Customers	9,767	10,048	(281)	(3)%
Total Number of Orders	23,626	26,328	(2,702)	(10)%
Average order value (AOV)	$41.13	$ 37.87	$ 3.26	9 %

Shutterfly Consumer net revenue decreased $25.1 million, or 3%, in 2018 compared to 2017. While organic Shutterfly Brand revenue grew 3%, in 2018 compared to 2017, the growth was offset by lost revenue from the brands and websites we shuttered in the 2017 platform consolidation and a year-over-year decline in the TinyPrints Boutique. Further, revenue declined due to a continuing mix shift away from free promotions, where customers receive the product for free but pay for shipping and handling, towards paid purchases.

Total Shutterfly Consumer segment customers decreased 3% and total number of orders decreased 10%, while AOV increased 9% in 2018 compared to 2017. These metrics reflect a combination of the effects of the platform consolidation, weak performance on promotions, the changing mix away from free and towards paid revenues, a decline in the Prints category and the TinyPrints Boutique, and soft new customer growth. AOV increased primarily due to the mix shift towards paid revenues and away from free, as well as product mix.

Shutterfly Consumer segment cost of net revenue decreased $4.4 million, or 1%, in 2018 compared to 2017. Shutterfly Consumer gross margin was 53% in 2018 compared to 54% in 2017. The decrease in gross margin was due to lower volumes, product mix, and an increase in amortization cost of revenue from capitalized technology expenses related to our strategic initiatives, partially offset by our higher AOV and the mix shift away from free revenues.

Shutterfly Consumer segment technology and development expense decreased $16.0 million, or 11% in 2018 compared to 2017. The overall decrease was primarily due to a decrease of $7.8 million in salaries and benefits due to lower bonus and lower headcount, a decrease of $6.3 million due to lower depreciation, and a decrease of $1.8 million in facilities costs. In 2018, we capitalized $31.0 million in eligible salary and consultant costs, including $1.2 million of stock-based compensation expense, associated with software developed or obtained for internal use, compared to $25.6 million capitalized in 2017, which included $1.3 million of stock-based compensation expense.

Shutterfly Consumer segment sales and marketing expense decreased $2.2 million, or 1%, in 2018 compared to 2017. The decrease in the Shutterfly Consumer sales and marketing expense was primarily due to a decrease of $6.6 million in salaries and benefits due to lower headcount and lower bonus partially offset by $4.8 million higher expense for working marketing dollars and promotional consumer platforms spend.

Shutterfly Consumer segment margin for 2018 was $201.4 million, a $1.8 million, or 1%, decrease, compared to 2017 due to decrease in revenue and gross margin. The segment margin improved to 21% in 2018 from 20% in 2017 primarily due to lower technology and development expense during 2018 compared to 2017.

Lifetouch Segment

	YEAR ENDED DECEMBER 31,			
	2018	2017	$ CHANGE	% CHANGE
	(dollars in thousands)			
LIFETOUCH				
Net revenue(1)	$ 798,718	$—	$ 798,718	100%
Cost of net revenue(2)(3)	299,467	—	299,467	100%
Technology and development(3)	21,711	—	21,711	100%
Sales and marketing(3)	288,578	—	288,578	100%
Credit card fees	8,951	—	8,951	100%
MARGIN	**$180,011**	**$—**	**$180,011**	**100%**
Margin %	*23%*	*—%*		

(1) Yearbook sales and collections for the Lifetouch segment are made throughout the school year, whereas yearbooks are typically delivered toward the end of the school year in the second quarter of the fiscal year. Business combination accounting principles require us to record the acquired deferred revenue at fair value on the acquisition date measured based on the cost to manufacture and deliver the yearbooks, plus a profit margin. Management reporting includes this purchase accounting adjustment which primarily relates to yearbook sales in net revenue for the Lifetouch segment. See reconciliation of "GAAP net revenue to Non-GAAP revenue" in "Non-GAAP Financial Measures" on page 56 of this Form 10-K.

(2) Business combination accounting principles require us to measure acquired inventory at fair value. The fair value of inventory reflects the acquired company's cost of manufacturing plus a portion of the expected profit margin. Management reporting excludes this purchase accounting adjustment from cost of net revenue for the Lifetouch segment.

(3) Excludes stock-based compensation expense and amortization of intangible assets.

We acquired Lifetouch on April 2, 2018. In the second quarter, Lifetouch has seasonality as the Schools business focuses on providing spring photography for grades K-8, as well as sports photography, yearbooks, and senior graduation photography. In the third quarter, Lifetouch experiences its peak season with the Fall School picture day tradition, the cornerstone program in the Schools business. Strong performances in both the Schools and Pre-School businesses in the second and third quarters of 2018 were supported by good account retention and solid growth in new accounts, leading to net account growth. This growth was partially offset by the Church business, which continues to decline.

Cost of net revenue in 2018 of $299.5 million primarily relates to salaries and benefits costs incurred to capture and produce photography products, and to a lesser extent, cost of net revenue expense related to direct materials and depreciation of production and photography equipment and manufacturing facilities.

Technology and development expenses in 2018 of $21.7 million primarily relate to salaries and benefit expenses for employees. Sales and marketing expenses in 2018 of $288.6 million primarily relate to costs incurred for marketing programs and personnel and related expenses to acquire host accounts (schools or churches) as well as the costs for marketing programs directed at the end-customer.

The Lifetouch segment margin in 2018 was $180.0 million. Lifetouch profits were driven primarily by the Schools business as noted above.

Shutterfly Business Solutions (SBS) Segment

	YEAR ENDED DECEMBER 31,			
	2018	2017	$ CHANGE	% CHANGE
	(dollars in thousands)			
SHUTTERFLY BUSINESS SOLUTIONS (SBS)				
Net revenue	$230,588	$193,239	$37,349	19 %
Cost of net revenue(1)	187,392	154,068	33,324	22 %
Technology and development(1)	13,614	17,907	(4,293)	(24)%
Sales and marketing(1)	6,067	4,476	1,591	36 %
MARGIN	**$ 23,515**	**$ 16,788**	**$ 6,727**	**40 %**
Margin %	*10%*	*9%*		

(1) Excludes stock-based compensation expense and amortization of intangible assets.

SBS segment net revenue increased $37.3 million, or 19%, in 2018 compared to 2017. SBS segment revenue growth was driven by a multi-year deal we signed in the third quarter of 2017 with an existing technology client, where volumes ramped more rapidly than planned in 2018.

SBS segment cost of net revenue increased $33.3 million, or 22%, in 2018 compared to 2017 primarily due to higher revenue. SBS gross margin was 19% in 2018 compared to 20% in 2017. The gross margin decrease was due to the new deal signed in the third quarter of 2017, which had lower margins during the client's initial ramp period.

SBS segment technology and development expenses decreased $4.3 million, or 24%, in 2018 compared to 2017. The overall decrease was primarily due to a decrease of $3.1 million for professional fees and $1.0 million in salaries and benefits. In 2018, we capitalized $6.6 million in eligible salary and consultant costs, associated with software developed or obtained for internal use, compared to $7.5 million capitalized in 2017.

SBS segment sales and marketing expense increased $1.6 million, or 36%, in 2018 compared to 2017. The increase was primarily due to an increase in employees' salaries and benefits.

SBS segment margin in 2018 was $23.5 million, a $6.7 million, or 40%, increase compared to 2017, driven by growth from the multi-year deal signed in the third quarter of 2017 as well as growth from other client wins.

Comparison of the Years Ended December 31, 2017 and 2016

	YEAR ENDED DECEMBER 31,			
	2017	2016	$ CHANGE	% CHANGE
	(dollars in thousands)			
CONSOLIDATED				
Net revenue	$1,190,202	$1,134,224	$ 55,978	5 %
Cost of net revenue	619,650	566,117	53,533	9 %
Restructuring	1,475	—	1,475	100 %
GROSS PROFIT	**569,077**	**568,107**	**970**	**— %**
Gross margin	*48%*	*50%*		
Operating expenses:				
Technology and development	168,383	166,909	1,474	1 %
Sales and marketing	197,708	233,585	(35,877)	(15)%
General and administrative	117,797	118,503	(706)	(1)%
Capital lease termination	8,098	—	8,098	100 %
Restructuring	15,491	—	15,491	100 %
TOTAL OPERATING EXPENSES	**507,477**	**518,997**	**(11,520)**	**(2)%**
Income from operations	61,600	49,110	12,490	25 %
Interest expense	(27,836)	(23,023)	(4,813)	21 %
Interest and other income, net	1,481	501	980	196 %
INCOME BEFORE INCOME TAXES	**35,245**	**26,588**	**8,657**	**33 %**
Provision for income taxes	(5,160)	(10,682)	5,522	(52)%
NET INCOME	**$ 30,085**	**$ 15,906**	**$ 14,179**	**89 %**

Net revenue increased $56.0 million, or 5%, in 2017 compared to 2016. Our Shutterfly Consumer and SBS segments represented 84% and 16%, respectively, of total net revenue in 2017. Revenue growth was attributable to increase in revenue from the SBS segment while revenue from the Shutterfly Consumer segment remained flat year over year.

Cost of net revenue

Cost of net revenue increased $53.5 million, or 9%, in 2017 compared to 2016. As a percentage of net revenue, cost of net revenue was 52% in 2017 compared to 50% in 2016. Gross margin decreased to 48% in 2017 from 50% in 2016 due to greater SBS segment mix and lower gross margin in the SBS segment.

Excluding amortization of intangible assets and stock-based compensation expense, our reportable segments contributed to the increase in cost of net revenue as follows:

- Cost of revenue for our SBS segment increased by $53.5 million, primarily driven by related increase in revenue.
- Cost of net revenue for our Shutterfly Consumer segment increased by $1.3 million.

Amortization of intangible assets expense for cost of net revenue decreased $1.0 million and stock-based compensation expense decreased

$0.2 million. Also impacting gross profit in 2017 was $1.5 million of restructuring charges related to inventory markdowns.

Technology and development

Our technology and development expense increased $1.5 million, or 1%, in 2017, compared to 2016 as we continue to invest in mobile, simplifying the customer experience, the Shutterfly consumer platform consolidation and our SBS Business. As a percentage of net revenue, technology and development expense decreased to 14% in 2017 from 15% in 2016. Excluding amortization of intangible assets and stock-based compensation expense, our reportable segments contributed to the increase in technology and development as follows:

- Technology and development for our SBS segment increased by $5.8 million.
- Technology and development for our Shutterfly Consumer segment decreased by $5.5 million.

Stock-based compensation expense increased $1.2 million in 2017 compared to 2016. As of December 31, 2017, headcount in technology and development decreased by 9% compared to December 31, 2016, reflecting our strategic focus on improving our long-term operating efficiency through the consumer platform consolidation.

Sales and marketing

Our sales and marketing expense decreased $35.9 million, or 15%, in 2017 compared to 2016. As a percentage of net revenue, total sales and marketing expense decreased to 17% in 2017 from 21% in 2016. Excluding amortization of intangible assets and stock-based compensation expense, our reportable segments contributed to the decrease in sales and marketing as follows:

- Sales and marketing for our Shutterfly Consumer segment decreased by $27.9 million.
- Sales and marketing for our SBS segment decreased by $0.5 million.

Amortization of intangible assets expense for sales and marketing decreased $4.2 million in 2017 compared to 2016 due to our intangible assets that became fully amortized. Stock-based compensation expense decreased $3.2 million in 2017 compared to 2016. As of December 31, 2017, headcount in sales and marketing decreased by 19% compared to December 31, 2016 reflecting our strategic focus on improving our long-term operating efficiency through the consumer platform consolidation

General and administrative

Our general and administrative expense decreased $0.7 million, or 1%, in 2017 compared to 2016. As a percentage of net revenue, general and administrative expense remained flat at 10% in 2017 and 2016. The decrease in general and administrative expense is primarily due to a decrease of $4.4 million in depreciation and amortization expense and a decrease of $0.7 million in credit card fees. These factors were partially offset by an increase of $1.8 million in personnel related costs related to bonuses, an increase of $1.4 million in facility costs, and an increase of $0.7 million in professional fees. General and administrative expense for 2017 includes acquisition-related expenses of approximately $2.0 million.

Capital lease termination

In 2017, there was an $8.1 million capital lease termination charge within operating expenses. This charge related to leased equipment from an existing vendor which we purchased and subsequently resold to HP, Inc. during the second quarter of fiscal 2017.

Restructuring expense

In 2017, there were $15.5 million of restructuring charges within operating expenses. These restructuring charges primarily consist of $8.4 million in depreciation expense of disposed assets and facility closures, and $5.9 million in employee-related costs such as severance and retention expense, and $1.2 million of other costs.

Interest expense

Interest expense was $27.8 million in 2017 compared to $23.0 million during 2016. The increase in interest expense is primarily due to our term loan issued in October 2017 and other associated costs for which we recorded $3.3 million of interest expense during 2017. Further, there was an increase of $0.8 million related to our convertible senior notes and an increase of $0.4 million related to our revolving credit facilities.

Provision for Income Taxes

We recorded an income tax provision of $5.2 million for 2017, compared to $10.7 million for 2016. Our effective tax rate was 15% in 2017 compared to 40% in 2016. Factors that impacted the effective tax rate include the recently enacted Tax Cuts and Jobs Act, federal research and development credit, limitation on executive compensation and disqualifying dispositions of employee incentive stock options.

Segment Information

In 2017 and 2016 we reported our financial performance based on the following reportable segments: Shutterfly Consumer and SBS. Our third reportable segment, Lifetouch, was added as a reportable segment in the second quarter of 2018 as a result of the acquisition of Lifetouch. The segment amounts included in this section are presented on a basis consistent with our internal management reporting.

Additional information on our reportable segments is contained in Note 15—*Segment Reporting* of the Notes to the Financial Statements (Part II, Item 8 of this Annual Report on Form 10-K).

Shutterfly Consumer Segment

	YEAR ENDED DECEMBER 31,			
	2017	2016	$ CHANGE	% CHANGE
	(dollars in thousands)			
SHUTTERFLY CONSUMER				
Net revenue	$ 996,963	$ 997,556	$ (593)	— %
Cost of net revenue(1)	456,665	455,387	1,278	— %
Technology and development(1)	140,698	146,216	(5,518)	(4)%
Sales and marketing(1)	170,687	198,583	(27,896)	(14)%
Credit card fees	25,645	26,319	(674)	(3)%
MARGIN	**$203,268**	**$171,051**	**$32,217**	**19 %**
Margin %	*20%*	*17%*		

(1) Excludes stock-based compensation expense and amortization of intangible assets.

	YEAR ENDED DECEMBER 31,			
	2017	2016	$ CHANGE	% CHANGE
	(figures in thousands, except AOV amounts)			
KEY CONSUMER METRICS				
Total Customers	10,048	10,116	(68)	(1)%
Total Number of Orders	26,328	27,109	(781)	(3)%
Average order value (AOV)	$ 37.87	$ 36.80	$1.07	3 %

Shutterfly Consumer net revenue remained relatively flat in 2017 compared to 2016. We experienced revenue declines in the non-Shutterfly brands due to the platform consolidation and the brand shutdowns during 2017. The decrease in non-Shutterfly brands was offset by growth in our core Shutterfly brand. The Shutterfly Consumer revenue represented 84% of total net revenue in 2017.

As it relates to the growth in our core Shutterfly brand, Shutterfly.com platform growth was 27% higher in the fourth quarter of 2017 compared to the fourth quarter of 2016. This metric is not like-for-like as it benefits this year from the TinyPrints boutique revenue, as well as higher year-over-year purchases of Shutterfly-brand products by customers migrating from our legacy websites. Excluding the TinyPrints boutique revenue, Shutterfly brand growth was 15% higher in the fourth quarter of 2017 compared to the fourth quarter of 2016. However, this metric is also not strictly like-for-like. Further, excluding the

higher purchases of Shutterfly-brand products by migrating customers gives us the best estimate for organic, like-for-like Shutterfly growth, which was 7% higher in the fourth quarter of 2017 compared to the fourth quarter of 2016 and 6% higher in the full year of 2017 compared to the full year of 2016.

Total Shutterfly Consumer customers decreased 1% and total number of orders decreased 3%, while AOV increased 3% in 2017 compared to 2016. The decrease in total customers and total number of orders was due to the consumer platform consolidation. AOV increased due to stronger year over year performance in our premium offerings as well as being more selective on our promotions.

Shutterfly Consumer cost of net revenue increased $1.3 million in 2017 compared to 2016.

Shutterfly Consumer gross profit remained flat at 54% in 2017 compared to 2016. In 2017, gross margin was impacted by $1.5 million of restructuring charges in the Shutterfly Consumer segment. These restructuring charges were related to the obsolete inventory markdowns as part of the Shutterfly Consumer segment restructuring.

Shutterfly Consumer segment technology and development expense decreased $5.5 million or 4% in 2017 compared to 2016. The overall decrease is primarily due to $4.2 million of lower depreciation expense and $3.4 million lower personnel costs including salary and benefits partially offset by an increase of $1.7 million in facilities costs and $0.4 million in professional services. In 2017, we capitalized $25.6 million in eligible salary and consultant costs including $1.3 million of stock-based compensation expense, associated with software developed or obtained for internal use, compared to $22.9 million, which included $1.3 million in stock-based compensation, capitalized in 2016.

Shutterfly Consumer segment sales and marketing expense decreased $27.9 million, or 14%, in 2017 compared to 2016. The overall decrease was primarily driven by a decrease of $28.4 million in marketing campaigns largely driven by more efficient external marketing spend as we migrated our smaller brands to the Shutterfly platform partially offset by $0.8 million increase in employee salaries and benefits.

Shutterfly Consumer segment margin was $203.3 million, a $32.2 million, or 19% increase, compared to 2016, due to decreases in sales and marketing as well as technology and development expenses.

SBS Segment

	YEAR ENDED DECEMBER 31,			
	2017	2016	$ CHANGE	% CHANGE
	(dollars in thousands)			
SHUTTERFLY BUSINESS SOLUTIONS (SBS)				
Net revenue	$193,239	$136,668	$56,571	41 %
Cost of net revenue(1)	154,068	100,582	53,486	53 %
Technology and development(1)	17,907	12,142	5,765	47 %
Sales and marketing(1)	4,476	5,005	(529)	(11)%
MARGIN	**$ 16,788**	**$ 18,939**	**$(2,151)**	**(11)%**
Margin %	*9%*	*14%*		

(1) Excludes stock-based compensation expense and amortization of intangible assets.

SBS net revenue increased $56.6 million, or 41%, in 2017 compared to 2016, and represented 16% of total net revenue in 2017. The increase in SBS net revenue came both from expansion of projects and higher volumes with existing clients, which included a new multi-year deal with an existing technology client.

SBS cost of net revenue increased $53.5 million, or 53%, in 2017 compared to 2016. The higher cost of net revenue is primarily due to increased costs associated with expansion of projects with our existing clients.

SBS segment technology and development expenses increased $5.8 million, or 47% in 2017 compared to 2016. The overall increase was primarily due to an increase of $2.9 million in employee salaries and expense, $2.2 million in professional fees and $0.4 million in facilities costs. In 2017, we capitalized $7.5 million in eligible salary and consultant costs associated with software developed or obtained for internal use, compared to $5.0 million capitalized in 2016.

SBS segment sales and marketing expense decreased $0.5 million, or 11% in 2017 compared to 2016. The decrease is primarily due to lower employee salaries and benefits.

SBS segment margin was $16.8 million, a $2.2 million, or a 11% decrease compared to 2016 driven primarily by higher cost of net revenue and technology and development expenses. The decrease in SBS segment margin is further impacted by lower gross margin on a major new deal we signed with an existing technology client which had low margins during the initial ramp up period. We expect gross margin in connection with this strategic relationship to be lower during the initial ramp period yet to improve over the life of the deal.

Liquidity and Capital Resources

At December 31, 2018, we had $521.6 million of cash and cash equivalents and $44.8 million of investments, primarily corporate debt, U.S. government and agency securities. In January 2019, the Company repaid $200.0 million of the Incremental Term Loan (defined below) that was used to finance the acquisition of Lifetouch. The Company ended January 2019 with cash, cash equivalents, and investments of approximately $216.6 million, down from December 31, 2018, driven by the debt repayment, and working capital used to pay vendors and suppliers used in the fourth quarter.

In May 2013, we issued $300.0 million of 0.25% convertible senior notes due May 15, 2018 (the “Senior Notes”) which were due and paid in May 2018. In August 2017, we entered into a syndicated credit facility (the “Credit Agreement”) which provides for (a) a five-year secured revolving loan facility in an aggregate principal amount of up to $200.0 million expiring in August 2022 (the “Revolving Loan Facility”) and (b) a seven-year secured delayed draw term loan facility in an aggregate principal amount of up to $300.0 million (the “Initial Term Loan”). The Credit Agreement permits us to add one or more incremental term loan facilities and/or increase the commitments for revolving loans subject to certain conditions.

In October 2017, we fully drew the $300.0 million Initial Term Loan under the Credit Agreement and used the proceeds to repay the Senior Notes due in May 2018. On April 2, 2018, we entered into an amendment under the Credit Agreement for an incremental term loan in an aggregate principal amount of $825.0 million (the “Incremental Term Loan”) to finance the acquisition of Lifetouch. The Initial Term Loan and the Incremental Term Loan have a maturity date of August 2024. The Revolving Loan Facility remains undrawn and available to us as of December 31, 2018.

The Credit Agreement fits well within our overall capital structure strategy. We seek to maintain adequate financial capacity to manage our seasonal cash flows, ensure a reasonable degree of operational flexibility and invest in value-creating growth. As part of this review, we affirmed our objective of maintaining gross leverage of 2.5-3.0x Adjusted EBITDA on an annual basis, and to return cash in excess of our operating and financing needs to shareholders in the form of share repurchases, within the parameters of appropriate cash management that meet the needs of our highly seasonal business, where substantially all of our cash flow is generated in the last four months of the year. Currently, our management team believes it will be in position to begin executing on a capital return plan during the fourth quarter of 2019.

Below is our cash flow activity for the years ended December 31, 2018, 2017 and 2016:

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
	(in thousands)		
CONSOLIDATED STATEMENTS OF CASH FLOWS DATA:			
Purchases of property and equipment	$ (41,396)	$ (36,745)	$ (56,264)
Capitalization of software and website development costs	(45,878)	(34,006)	(33,423)
Depreciation and amortization	151,127	103,862	113,651
Acquisition of business, net of cash acquired	(890,204)	—	—
Cash flows provided by operating activities	201,926	239,524	193,423
Cash flows used in investing activities	(730,915)	(195,362)	(64,401)
Cash flows provided by (used in) financing activities	561,734	156,508	(128,661)

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

We generally spend approximately 5% to 10% of our net revenue in capital expenditures. We anticipate this level of capital expenditures to remain consistent in 2019, after including the expenditures related to Project Aspen. These expenditures will be used to improve the mobile experience, to develop the SBS platform, to purchase technology and equipment to support the growth in our business, to increase our production capacity, to simplify the process of creating and purchasing personalized products and by continuing to expand the range of products we offer our customers, and to make developments to Shutterfly Photos. This range of capital expenditures is not outside the ordinary course of our business or materially different from how we have expanded our business in the past.

Operating Activities. For 2018, net cash provided by operating activities was $201.9 million primarily due to our net income of $50.4 million and adjustments for non-cash items of $151.1 million for depreciation and amortization, $47.7 million for stock-based compensation expense, $8.8 million for debt discount and issuance costs, $5.6 million provision from deferred income taxes, and restructuring expense of $2.4 million partially offset by $63.5 million for repayment of convertible senior notes attributable to debt discount.

For 2017, net cash provided by operating activities was $239.5 million primarily due to our net income of $30.1 million and the net change in operating assets and liabilities of $34.6 million. Adjustments for non-cash items included $103.9 million of depreciation and amortization, $43.6 million in stock-based compensation expense, $15.5 million of debt discount and issuance costs, and restructuring expense of $10.9 million.

For 2016, net cash provided by operating activities was $193.4 million. Adjustments for non-cash items included $93.5 million of depreciation and amortization, which increased by $7.2 million over the prior year due to an increase in equipment capital leases. Additional adjustments for non-cash items included $45.7 million of stock-based compensation, $20.1 million of amortization of intangible assets,

$14.4 amortization of debt discount and issuance costs, and $8.9 million provision from deferred income taxes.

Investing Activities. For 2018, net cash used in investing activities was $730.9 million primarily due to $890.2 million for cash used for Lifetouch acquisition, net of cash acquired, $41.4 million used for capital expenditures for computer and network hardware to support our website infrastructure and information technology systems and production equipment for our manufacturing and production operations. We also used $45.9 million for capitalized software and website development costs and $9.5 million for the purchase of investments. This was partially offset by proceeds from the sales and maturities of investments of $253.1 million and proceeds from sale of property and equipment of $3.0 million.

For 2017, net cash used in investing activities was $195.4 million. We used $36.7 million for capital expenditures for computer and network hardware to support our website infrastructure and information technology systems and production equipment for our manufacturing and production operations. We also used $34.0 million for capitalized software and website development costs and $205.5 million for the purchase of investments. This was partially offset by proceeds from the sales and maturities of investments of $59.1 million and proceeds from sale of property and equipment of $21.7 million.

For 2016, net cash used in investing activities was $64.4 million. We used $56.3 million for capital expenditures, $33.4 million for capitalized software and website development and $29.4 million to purchase investments. This was partially offset by proceeds from the sales and maturities of investments of $40.4 million and proceeds from sale of property and equipment of $14.3 million.

Financing Activities. For 2018, net cash provided by financing activities was $561.7 million, related to proceeds from borrowings, net of issuance costs of $806.7 million and proceeds from issuance of common stock from the exercise of stock options of $20.2 million. This was partially offset by $246.1 million of cash used for principal payments of our borrowings (primarily the repayment in connection with the maturity of our Senior Notes) and $19.0 million in payments for capital leases and financing obligations.

For 2017, net cash provided by financing activities was $156.5 million. We received proceeds, net of issuance costs of $295.2 million from the term loan issued in October 2017, and proceeds of $0.7 million from the issuance of common stock from the exercise of options. This was partially offset by the use of $110.0 million to repurchase shares of our common stock and $29.4 million in payments for capital leases and financing obligations.

For 2016, net cash used in financing activities was $128.7 million. We used $112.5 million to repurchase shares of our common stock, $19.4 million for payments of capital leases and financing obligations and $1.3 million for payments related to contingent considerations related to Groovebook. We also received $2.1 million of proceeds from issuance of common stock from the exercise of options and recorded $2.4 million from excess tax benefit from stock-based compensation.

Non-GAAP Financial Measures

Regulation G, conditions for use of Non-Generally Accepted Accounting Principles ("Non-GAAP") financial measures, and other SEC regulations define and prescribe the conditions for use of certain Non-GAAP financial information. We closely monitor five financial measures, Non-GAAP net revenue, Non-GAAP net income (loss), Non-GAAP net income (loss) per share, adjusted EBITDA, and free cash flow which meet the definition of Non-GAAP financial measures. We define Non-GAAP net revenue as net revenue excluding purchase accounting adjustments. We define Non-GAAP net income (loss) and Non-GAAP net income (loss) per share as net income (loss) and net income (loss) per share excluding restructuring, capital lease termination charge, benefit from the Tax Cuts and Jobs Act legislation, acquisition-related charges, and purchase accounting adjustments. We define adjusted EBITDA as earnings before interest, taxes, depreciation, amortization, stock-based compensation, restructuring, acquisition-related charges, capital lease termination charge and purchase accounting adjustments. Free cash flow is defined as cash provided by operating activities less capital expenditures. Management believes these Non-GAAP financial measures reflect an additional way of viewing our profitability and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our earnings and cash flows. Refer below for a reconciliation of Non-GAAP net revenue, Non-GAAP net income (loss), Non-GAAP net income (loss) per share, adjusted EBITDA and free cash flow to the most comparable GAAP measure.

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

The table below shows the trend of Non-GAAP net revenue, Non-GAAP net income, Non-GAAP net income per share, Non-GAAP adjusted EBITDA, and free cash flow as a percentage of net revenue for the years ended December 31, 2018, 2017, and 2016 (in thousands except per share amounts and percentages):

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
GAAP net revenue	$1,961,820	$1,190,202	$1,134,224
Non-GAAP net revenue	$2,001,135	$1,190,202	$1,134,224
GAAP net income	$ 50,396	$ 30,085	$ 15,906
GAAP net income % of net revenue	*3%*	*3%*	*1%*
GAAP net income per share	$ 1.45	$ 0.88	$ 0.45
Non-GAAP net income	$ 106,191	$ 35,828	$ 15,906
Non-GAAP net income % of net revenue	*5%*	*3%*	*1%*
Non-GAAP net income per share	$ 3.05	$ 1.05	$ 0.45
Non-GAAP adjusted EBITDA	$ 385,006	$ 234,099	$ 208,453
Non-GAAP adjusted EBITDA % of net revenue	*20%*	*20%*	*18%*
Free cash flow	$ 178,162	$ 168,773	$ 113,563
Free cash flow % of net revenue	*9%*	*14%*	*10%*

For 2018, 2017 and 2016, our Non-GAAP net revenue was $2,001.1 million, $1,190.2 million, and $1,134.2 million, respectively.

For 2018, 2017 and 2016, our Non-GAAP net income was $106.2 million, $35.8 million and $15.9 million, respectively. In addition, for 2018, 2017 and 2016, Non-GAAP net income per share was $3.05, $1.05 and $0.45, respectively.

For 2018, 2017 and 2016, our adjusted EBITDA was $385.0 million, $234.1 million and $208.5 million, respectively.

For 2018, 2017 and 2016, our free cash flow was $178.2 million, $168.8 million and $113.6 million, respectively.

By carefully managing our operating costs and capital expenditures, we are able to make the strategic investments we believe are necessary to grow and strengthen our business while maintaining the opportunity for full year adjusted EBITDA profitability and improving free cash flow.

The following is a reconciliation of Non-GAAP revenue, Non-GAAP net income, Non-GAAP net income per share, adjusted EBITDA, and free cash flow to the most comparable GAAP measure, for the years ended December 31, 2018, 2017 and 2016 (in thousands except per share amounts):

Reconciliation of Net Revenue to Non-GAAP Net Revenue

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
GAAP NET REVENUE	**$1,961,820**	**$1,190,202**	**$1,134,224**
Purchase accounting deferred revenue adjustment	39,315	—	—
NON-GAAP NET REVENUE	**$2,001,135**	**$1,190,202**	**$1,134,224**

Reconciliation of Net Income to Non-GAAP Net Income

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
GAAP NET INCOME	**$50,396**	**$30,085**	**$15,906**
Capital lease termination	—	8,098	—
Restructuring	4,618	16,966	—
Acquisition-related charges	15,549	—	—
Purchase accounting adjustments	50,538	—	—
Tax benefit impact of non-recurring items	(14,910)	(10,446)	—
Benefit from 2017 tax reform legislation	—	(8,875)	—
NON-GAAP NET INCOME	**$106,191**	**$ 35,828**	**$15,906**
GAAP diluted shares outstanding	34,832	34,106	35,190
Non-GAAP diluted shares outstanding	34,832	34,106	35,190
GAAP NET INCOME PER SHARE	**$ 1.45**	**$ 0.88**	**$ 0.45**
NON-GAAP NET INCOME PER SHARE	**$ 3.05**	**$ 1.05**	**$ 0.45**

Reconciliation of Net Income to Non-GAAP Adjusted EBITDA

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
NET INCOME	**$ 50,396**	**$ 30,085**	**$ 15,906**
Add back:			
Interest expense	61,239	27,836	23,023
Interest and other income, net	(5,444)	(1,481)	(501)
Provision from income taxes	9,262	5,160	10,682
Depreciation and amortization	151,127	103,862	113,651
Stock-based compensation expense	47,721	43,573	45,692
Purchase accounting adjustments	50,538	—	—
Acquisition-related charges	15,549	—	—
Capital lease termination	—	8,098	—
Restructuring	4,618	16,966	—
NON-GAAP ADJUSTED EBITDA	**$385,006**	**$234,099**	**$208,453**

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

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016(1)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**$201,926**	**$239,524**	**$193,423**
Add back:			
Interest expense	61,239	27,836	23,023
Interest and other income, net	(5,444)	(1,481)	(501)
Provision for income taxes	9,262	5,160	10,682
Changes in operating assets and liabilities	(132)	(34,634)	3,772
Other adjustments	49,868	(16,488)	(21,946)
Capital lease termination	—	8,098	—
Cash restructuring	2,200	6,084	—
Acquisition-related charges	15,549	—	—
Purchase accounting adjustments	50,538	—	—
NON-GAAP ADJUSTED EBITDA	**$385,006**	**$234,099**	**$208,453**

(1) We reclassified an immaterial contingent consideration payment (to Groovebook Founders) in the first quarter of 2016 between operating and financing activities within the cash flow statement.

Reconciliation of Cash Flow From Operating Activities to Non-GAAP Free Cash Flow

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
NET CASH PROVIDED BY OPERATING ACTIVITIES	**$201,926**	**$239,524**	**$193,423**
Purchase of property and equipment	(41,396)	(36,745)	(56,264)
Capitalization of software and website development costs	(45,878)	(34,006)	(33,423)
Capex adjustment(1)	—	—	9,827
Repayment of convertible senior notes attributable to debt discount(2)	63,510	—	—
FREE CASH FLOW	**$178,162**	**$168,773**	**$113,563**

(1) Excludes purchase of printers of $9.8 million that we acquired and immediately sold during the second quarter of 2016.

(2) Excludes $63.5 million related to certain cash outflows attributable to the repayment of the accreted interest on the convertible senior notes that were settled in the second quarter of 2018.

Contractual Obligations

The following are contractual obligations at December 31, 2018, associated with our borrowings, lease obligations and other arrangements:

	TOTAL	LESS THAN 1 YEAR	1-3 YEARS	3-5 YEARS	MORE THAN 5 YEARS
			(in thousands)		
CONTRACTUAL OBLIGATIONS					
Initial Term Loan, including interest(1)	$ 372,673	$ 16,915	$ 32,761	$ 32,196	$ 290,801
Incremental Term Loan, including interest	1,045,571	50,453	95,320	94,137	805,661
Notes assumed from the acquisition of Lifetouch	7,238	3,310	3,190	738	—
Capital lease obligations	59,423	16,853	20,490	18,057	4,023
Operating lease obligations(2)	68,351	23,557	31,493	11,800	1,501
Build-to-suit arrangement obligations(3)	39,889	6,501	13,440	13,426	6,522
Purchase obligations(4)	80,639	51,033	28,694	912	—
TOTAL CONTRACTUAL OBLIGATIONS	**$1,673,784**	**$168,622**	**$225,388**	**$171,266**	**$1,108,508**

(1) The Term Loan principal of $300.0 million bears a variable interest rate of one-month LIBOR, subject to a 0.0% floor, plus an applicable margin of 2.50% per annum and therefore, is subject to change in future periods. We entered into certain interest-rate swap agreements that have the economic effect of modifying a notional amount of $150.0 million of the Term Loan so that the interest payable on such portion became fixed at 4.27%. Interest payments on the Term Loan have been presented above after consideration of these variable to fixed interest-rate swap agreements. See Part II, Item 8 of this annual report on Form 10-K "Financial Statements and Supplementary Data—Notes to Consolidated Financial Statements—Note 8—*Derivative Financial Instruments* and Note 14—*Debt*" for further discussion.

(2) Includes office space in Redwood City, California and certain other facilities under non-cancelable operating leases.

(3) Includes the estimated timing and amount of payments for rent for our leased production facility spaces in Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona. See Part II, Item 8 of this annual report on Form 10-K "Financial Statements and Supplementary Data—Notes to Consolidated Financial Statements—Note 9—*Commitments and Contingencies*" for further discussion.

(4) Includes co-location agreements with third-party hosting facilities that expire in 2022, and an agreement to migrate to the cloud that expires in 2022 as well as minimums under marketing agreements.

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

Off-Balance Sheet Arrangements

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

As of December 31, 2018, the Company has stand-by letters of credit, totaling approximately $18.7 million, for the benefit of the Company's workers' compensation insurance carriers. There were no amounts drawn against any of the letters of credit at December 31, 2018. The letters of credit are secured by collateral in the form of a certificate of deposit, which is treated as restricted other current asset and is recorded in other current assets on the balance sheet.

Recent Accounting Pronouncements

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 2 - *Summary of Significant Accounting Policies* of Notes to Consolidated Financial Statements included elsewhere in this Annual Report.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate and Credit Risk. We have exposure to interest rate risk that relates primarily to our investment portfolio and our borrowings that bear variable interest rates under our syndicated credit facility. We maintain our portfolio of cash equivalents and investments in a variety of money market funds, corporate debt, U.S. government and agency securities. All of our cash equivalents are carried at market value. Our syndicated credit facility provides for (a) a five-year secured revolving loan facility in an aggregate principal amount of up to $200.0 million ("Revolving Loan Facility") and (b) a seven-year delayed draw secured term loan facility with an initial aggregate principal amount of up to $300.0 million ("Initial Term Loan") with the option for an amendment to enter into an incremental term loan facility ("Incremental Term Loan"). We may draw funds from our syndicated credit facility under interest rates based on either the Federal Funds Rate or the Adjusted London Interbank Offered Rate ("LIBOR rate"). If these rates increase significantly, our costs to borrow these funds will also increase.

As of December 31, 2018, we had not borrowed any funds under our Revolving Loan Facility. In October 2017, we fully drew $300.0 million under the Initial Term Loan with a maturity date of August 2024, of which $297.0 million remains outstanding as of December 31, 2018. Further, in April 2018, we entered into an amendment under our existing syndicated credit facility for an Incremental Term Loan in an aggregate principal amount of $825.0 million which has been drawn with a maturity date of August 2024, of which $820.9 million remains outstanding as of December 31, 2018. In January 2019, we prepaid $200.0 million of our Incremental Term Loan.

In August 2017, in order to mitigate future interest-rate risk, we entered into interest-rate swap agreements ("Swap Agreements") with an aggregate notional amount of $150.0 million and an effective date of October 18, 2017. These Swap Agreements have the economic effect of modifying a portion of the variable interest-rate obligations associated with our Initial Term Loan so that the interest payable on such portion of the Initial Term Loan became fixed at a rate of 4.27% (refer to Note 8 and Note 14 of Notes to Consolidated Financial Statements for further details regarding the Initial Term Loan and the Swap Agreements). Changes in the overall level of interest rates affect the fair value of the Swap Agreements that we recognize in our consolidated balance sheet. As of December 31, 2018, if LIBOR-based interest rates would have been higher by 100 basis points, the aggregate fair value of the Swap Agreements would have increased by approximately $6.6 million.

If LIBOR-based interest rates would have increased by 100 basis points, annual interest expense would have increased by approximately $9.7 million as it relates to our borrowings that bear variable interest rates (including the new Incremental Term Loan). Further, we do not believe that a 100 basis points change in interest rates would have a significant impact on our interest income.

Inflation. We do not believe that inflation has had a material effect on our current business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, for example, if the cost of our materials or the cost of shipping our products to customers were to incur substantial increases as a result of the rapid rise in the cost of oil, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Investment. The primary objective of our investment activities is to preserve principal while at the same time improving yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of asset types, including bank deposits, money market funds, corporate debt and U.S government and agency securities. As of December 31, 2018, our investments totaled $44.8 million, which represented approximately 28% of our total investment portfolio.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SHUTTERFLY, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

69 Report of Independent Registered Public Accounting Firm
71 Consolidated Balance Sheets
72 Consolidated Statements of Operations
73 Consolidated Statements of Stockholders' Equity
74 Consolidated Statement of Comprehensive Income (Loss)
75 Consolidated Statements of Cash Flows
77 Notes to Consolidated Financial Statements
117 Schedule II—Valuation and Qualifying Accounts for the years ended December 31, 2018, 2017, and 2016

Report of Independent Registered Public Accounting Firm

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

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Shutterfly, Inc. and its subsidiaries (the "Company") as of December 31, 2018 and December 31, 2017, and the related consolidated statements of operations, stockholders' equity, comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2018, including the related notes and financial statement schedule listed in the accompanying index (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and December 31, 2017**,** and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework* (2013) issued by the COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As described in Management's Report on Internal Control over Financial Reporting, management has excluded Lifetouch Inc. from its assessment of internal control over financial reporting as of December 31, 2018 because it was acquired by the Company in a purchase business combination during 2018. We have also excluded Lifetouch Inc. from our audit of internal control over financial reporting. Lifetouch Inc. is a wholly-owned subsidiary whose total assets and total revenues excluded from management's assessment and our audit of internal control over financial reporting represent 10% and 39%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2018.

Definition and Limitations of Internal Control over Financial Reporting

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

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

/s/ PricewaterhouseCoopers LLP

San Jose, California
February 28, 2019

We have served as the Company's auditor since 2001.

SHUTTERFLY, INC. CONSOLIDATED BALANCE SHEETS

(In thousands, except par value amounts)

	DECEMBER 31,	
ASSETS	**2018**	**2017**
Current assets:		
Cash and cash equivalents	$ 521,567	$ 489,894
Short-term investments	34,011	178,021
Accounts receivable, net	87,023	82,317
Inventories	18,015	11,019
Prepaid expenses and other current assets	66,961	41,383
TOTAL CURRENT ASSETS	**727,577**	**802,634**
Long-term investments	10,808	9,242
Property and equipment, net	381,018	266,860
Intangible assets, net	316,154	29,671
Goodwill	843,607	408,975
Other assets	23,045	17,418
TOTAL ASSETS	**$2,302,209**	**$1,534,800**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 14,203	$ 297,054
Accounts payable	105,407	91,473
Accrued liabilities	226,445	159,248
Deferred revenue, current portion	57,319	24,649
TOTAL CURRENT LIABILITIES	**403,374**	**572,424**
Long-term debt	1,090,442	292,457
Other liabilities	134,027	119,195
TOTAL LIABILITIES	**1,627,843**	**984,076**
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock, $0.0001 par value; 100,000 shares authorized; 33,673 and 32,297 shares issued and outstanding on December 31, 2018 and 2017, respectively	3	3
Additional paid-in capital	1,065,531	996,301
Accumulated other comprehensive income	1,592	1,778
Accumulated deficit	(392,760)	(447,358)
TOTAL STOCKHOLDERS' EQUITY	**674,366**	**550,724**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$2,302,209**	**$1,534,800**

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

SHUTTERFLY, INC. CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
Net revenue	$ 1,961,820	$1,190,202	$1,134,224
Cost of net revenue	961,575	619,650	566,117
Restructuring	—	1,475	—
GROSS PROFIT	**1,000,245**	**569,077**	**568,107**
Operating expenses:			
Technology and development	177,001	168,383	166,909
Sales and marketing	505,833	197,708	233,585
General and administrative	197,340	117,797	118,503
Capital lease termination	—	8,098	—
Restructuring	4,618	15,491	—
TOTAL OPERATING EXPENSES	**884,792**	**507,477**	**518,997**
Income from operations	115,453	61,600	49,110
Interest expense	(61,239)	(27,836)	(23,023)
Interest and other income, net	5,444	1,481	501
INCOME BEFORE INCOME TAXES	**59,658**	**35,245**	**26,588**
Provision for income taxes	(9,262)	(5,160)	(10,682)
NET INCOME	**$ 50,396**	**$ 30,085**	**$ 15,906**
Net income per share:			
Basic	$ 1.52	$ 0.91	$ 0.47
DILUTED	**$ 1.45**	**$ 0.88**	**$ 0.45**
Weighted average shares:			
Basic	33,258	33,113	34,097
DILUTED	**34,832**	**34,106**	**35,190**
Stock-based compensation expense is allocated as follows (Note 10):			
Cost of net revenue	$ 3,824	$ 4,339	$ 4,579
Technology and development	9,990	9,778	8,550
Sales and marketing	12,790	12,229	15,445
General and administrative	21,117	17,227	17,118
Restructuring	—	814	—

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

SHUTTERFLY, INC. CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
COMMON STOCK (PAR VALUE)			
Balance, beginning of year	$ 3	$ 3	$ 4
Issuance of common stock upon exercise of options and vesting of restricted stock units	—	1	1
Common stock repurchased and retired	—	(1)	(2)
BALANCE, END OF YEAR	**3**	**3**	**3**
ADDITIONAL PAID-IN CAPITAL			
Balance, beginning of year	996,301	949,864	900,218
Issuance of common stock upon exercise of options and vesting of restricted stock units	20,166	677	2,104
Stock based compensation, net of forfeitures	49,066	45,760	47,252
Tax benefit of stock options	—	—	290
Convertible notes settlement	(2)	—	—
BALANCE, END OF YEAR	**1,065,531**	**996,301**	**949,864**
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)			
Balance, beginning of year	1,778	(32)	(68)
Foreign currency translation losses	(1,114)	—	—
Unrealized gain (loss) on investments, net of tax	10	(27)	36
Unrealized gain on cash flow hedges, net of tax	918	1,837	—
BALANCE, END OF YEAR	**1,592**	**1,778**	**(32)**
ACCUMULATED DEFICIT			
Balance, beginning of year	(447,358)	(390,674)	(294,092)
Impact of adoption of new accounting standards	4,202	23,231	—
Common stock repurchased and retired	—	(110,000)	(112,488)
Net income	50,396	30,085	15,906
BALANCE, END OF YEAR	**(392,760)**	**(447,358)**	**(390,674)**
TOTAL STOCKHOLDERS' EQUITY	**$ 674,366**	**$ 550,724**	**$ 559,161**
NUMBER OF SHARES			
Common stock			
Balance, beginning of year	32,297	33,637	34,777
Issuance of common stock upon exercise of options and vesting of restricted stock units	1,376	986	1,385
Common stock repurchased and retired	—	(2,326)	(2,525)
BALANCE, END OF YEAR	**33,673**	**32,297**	**33,637**

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

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

(In thousands)

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
Net income	$ 50,396	$ 30,085	$ 15,906
Other comprehensive income (loss), net of reclassification adjustments:			
Foreign currency translation losses	(1,114)	—	—
Unrealized net gains (losses) on investments	14	(72)	66
Tax benefit (expense) on unrealized net gains (losses) on investments	(4)	39	(30)
Unrealized gains on cash flow hedges	1,225	2,979	—
Tax expense on unrealized gains on cash flow hedges	(307)	(1,136)	—
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	**(186)**	**1,810**	**36**
COMPREHENSIVE INCOME	**$50,210**	**$31,895**	**$15,942**

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

SHUTTERFLY, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 50,396	$ 30,085	$ 15,906
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	110,703	88,946	93,531
Amortization of intangible assets	40,424	14,916	20,120
Amortization of debt discount and issuance costs	8,792	15,508	14,432
Repayment of convertible senior notes attributable to debt discount	(63,510)	—	—
Stock-based compensation	47,721	43,573	45,692
(Gain) loss on disposal of property and equipment	(252)	1,141	738
Deferred income taxes	5,630	(161)	8,899
Tax benefit from stock-based compensation	—	—	290
Excess tax benefits from stock-based compensation	—	—	(2,413)
Restructuring	2,418	10,882	—
Other	(528)	—	—
Changes in operating assets and liabilities, net of acquisition:			
Accounts receivable	2,937	(24,952)	(2,142)
Inventories	12,766	(743)	1,715
Prepaid expenses and other assets	5,680	5,603	(19,140)
Accounts payable	4,223	32,189	27,128
Accrued and other liabilities	(25,474)	22,537	(11,333)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**201,926**	**239,524**	**193,423**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisition of business, net of cash acquired	(890,204)	—	—
Purchases of property and equipment	(41,396)	(36,745)	(56,264)
Capitalization of software and website development costs	(45,878)	(34,006)	(33,423)
Purchases of investments	(9,523)	(205,466)	(29,422)
Proceeds from maturities of investments	206,231	45,257	28,234
Proceeds from sales of investments	46,879	13,874	12,213
Proceeds from sales of property and equipment	2,976	21,724	14,261
NET CASH USED IN INVESTING ACTIVITIES	**(730,915)**	**(195,362)**	**(64,401)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of common stock upon exercise of stock options	20,166	677	2,104
Repurchases of common stock	—	(110,000)	(112,488)
Excess tax benefits from stock-based compensation	—	—	2,413
Principal payments of capital lease and financing obligations	(19,032)	(29,380)	(19,377)
Payment for contingent consideration liabilities	—	—	(1,313)
Principal payments of borrowings	(246,052)	—	—
Proceeds from borrowings, net of issuance costs	806,652	295,211	—
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	**561,734**	**156,508**	**(128,661)**
Effect of exchange rate changes on cash and cash equivalents	(1,072)	—	—
Net increase in cash and cash equivalents	31,673	200,670	361
Cash and cash equivalents, beginning of period	489,894	289,224	288,863
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$ 521,567**	**$ 489,894**	**$ 289,224**

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

SHUTTERFLY, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Interest	$47,099	$ 5,567	$ 3,231
Income taxes	6,532	780	1,561
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING / FINANCING ACTIVITIES:			
Net increase (decrease) in accrued purchases of property and equipment	$ 1,607	$ 2,693	$ (4,013)
Net increase (decrease) in accrued capitalized software and website development costs	69	(396)	(319)
Stock-based compensation capitalized with software and website development costs	1,345	1,373	1,560
Property and equipment acquired under capital leases	5,611	19,145	23,946

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

SHUTTERFLY, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Description of Business

Shutterfly, Inc. (the "Company" or "Shutterfly") is the leading retailer and manufacturing platform for personalized products and communications. Founded and incorporated in the state of Delaware in 1999, Shutterfly has three segments: Shutterfly Consumer, Lifetouch, and Shutterfly Business Solutions ("SBS"). Shutterfly Consumer and Lifetouch help consumers capture, preserve, and share life's important moments through professional and personal photography, and personalized products. The Shutterfly brand brings photos to life in photo books, gifts, home décor, and cards and stationery. Lifetouch is the national leader in school photography, built on the enduring tradition of "Picture Day," and also serves families through portrait studios and other partnerships. SBS delivers digital printing services that enable efficient and effective customer engagement through personalized communications. The Company is headquartered in Redwood City, California.

On April 2, 2018, the Company completed its acquisition of Lifetouch, Inc. ("Lifetouch"). As a result of the acquisition, the Company has a new reportable segment for the Lifetouch business (refer to Note 15—*Segment Reporting* for further details).

Note 2—Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries including the financial results of Lifetouch which are included prospectively from the acquisition date of April 2, 2018. All intercompany transactions and balances have been eliminated.

Foreign Currency Translation

As a result of the acquisition of Lifetouch, the Company has subsidiaries in Canada for which the functional currency is the local currency. As such, exchange rate fluctuations for these subsidiaries are included in stockholders' equity as a component of accumulated other comprehensive income (loss). Prior to the acquisition of Lifetouch, the Company only had one foreign subsidiary in Israel for which the functional currency is the U.S. Dollar and exchange rate fluctuations are recorded as part of earnings. Gains and losses from foreign currency transactions which are included in interest and other income, net in the accompanying consolidated statements of operations were immaterial for the years ended December 31, 2018, 2017 and 2016.

Use of Estimates

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

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of 90 days or less to be cash equivalents. Management determines the appropriate classification of cash equivalents at the time of purchase and reevaluates such designations at each balance sheet date. Cash equivalents primarily consist of money market funds (primarily invested in U.S. government obligations), commercial paper and corporate debt securities.

Fair Value

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

which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

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

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

Investments

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

The Company assesses whether an other-than-temporary impairment loss on its investments has occurred due to declines in fair value or other market conditions. With respect to the Company's debt securities, this assessment takes into account the severity and duration of the decline in value, its intent to sell the security, whether it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, and whether it expects to recover the entire amortized cost basis of the security (that is, whether a credit loss exists). The Company did not recognize any other-than-temporary impairment losses on its investments in the years ended December 31, 2018, 2017 or 2016.

Derivative Financial Instruments

The Company uses derivative financial instruments to manage interest-rate risk. The Company accounts for these instruments in accordance with Accounting Standards Codification ("ASC") 815, *Derivatives and Hedging* ("ASC 815"), which requires that every derivative instrument be recorded on the balance sheet as either an asset or a liability measured at its fair value as of the reporting date. ASC 815 also requires that changes in the derivatives' fair values be recognized in earnings, unless specific hedge accounting documentation criteria is met. Based on the intended use of the derivative instruments and hedge accounting documentation criteria, the Company has designated the aforementioned derivative instruments as qualifying hedging instruments and is accounting for them as cash flow hedges pursuant to ASC 815.

The Company uses the hypothetical method to assess the effectiveness of the derivatives. The fair value of the derivatives is recognized gross as other assets or other liabilities and the corresponding changes in the fair values are recorded in accumulated other comprehensive income (loss) in the consolidated balance sheet. Since the hedged item is interest expense, amounts recorded in other comprehensive income (loss) are reclassified to interest expense when the hedged interest payment is accrued. The periodic interest settlements for the derivative instruments are recorded as interest expense and are included as part of the cash flows from operating activities.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist principally of cash, cash equivalents, investments, derivatives instruments and accounts receivable. As of December 31, 2018, the Company's cash and cash equivalents were maintained by financial institutions in the United States and its deposits may be in excess of insured limits. The Company believes that the financial institutions that hold its investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments. Similarly, the Company's derivative contracts are transacted with various financial institutions with high credit standings, and accordingly, minimum credit risk exists with respect to these derivative contracts.

The Company's accounts receivable are derived primarily from sales to customers located in the United States and who make payments through credit cards. Accounts receivable primarily relates

to receivables from customers who make payments through credit cards as well as receivables from SBS customers. Credit card receivables settle relatively quickly, and the Company's historical experience of credit card losses have not been material and have been within management's expectations. Excluding amounts due from credit cards of customers, as of December 31, 2018, two SBS customers accounted for 40% and 34% of the Company's net accounts receivable. No other customers accounted for 10% or more of net accounts receivable as of December 31, 2018. As of December 31, 2017, excluding amounts due from credit cards of customers, two SBS customers accounted for 55% and 35% of the Company's net accounts receivable. No other customers accounted for 10% or more of net accounts receivable as of December 31, 2017. No customer accounted for 10% or more of net revenue in the years ended December 31, 2018, 2017, and 2016.

Valuation of Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. The value of inventories is reduced by estimates for excess and obsolete inventories. The estimate for excess and obsolete inventories is based upon management's review of utilization of inventories in light of projected sales, current industry conditions and industry trends. Inventories are primarily raw materials and consist principally of paper, photo book, year book and church directory, as well as packaging supplies and raw materials for gifts.

Deferred Costs

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

Property and Equipment

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

Software and Website Development Costs

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

Long-Lived Assets

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

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Intangible assets resulting

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

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

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

Lease Obligations

The Company categorizes leases at their inception as either operating or capital leases. On certain of the Company's lease agreements, the Company may receive rent holidays and other lease incentives. The Company recognizes lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays that defer the commencement date of required payments. Additionally, lease incentives received for leases categorized as operating leases are treated as a reduction of the Company's costs over the term of the agreement. With regard to lease incentives received for leases categorized as capital leases, the capital lease asset and related capital lease liability recorded at the beginning of the lease term is reduced by the lease incentive.

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

Revenue Recognition

The Company derives its revenue from Shutterfly Consumer, Lifetouch and SBS product sales, net of applicable sales tax collected from customers, which are remitted to governmental authorities. Revenue is recognized when control of the promised products or services is transferred to its customers in an amount that reflects the consideration it expects to be entitled to in exchange for those products or services. Cash discounts are available to be used by customers at the time of the purchase and are deducted from gross revenue in determining net revenue. Allowances for sales returns, which reduce revenue and cost of sales, are estimated using historical experience. In arrangements with multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price. The Company generally determines stand-alone selling prices based on the prices charged to customers or using expected cost plus a margin. Shipping charged to its customers is recognized as revenue upon shipment and the related shipping costs are recognized as cost of net revenue.

Shutterfly Consumer. The Company's Shutterfly Consumer revenue is primarily derived from the sale of products such as, cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and prints, etc. Customers place Shutterfly Consumer product

orders through the Shutterfly website or mobile apps and pay primarily using credit cards. The credit card payments are charged, and revenue is recognized upon shipment of the fulfilled orders, which generally occurs upon delivering to the carrier

Lifetouch. The Company's Lifetouch revenue is primarily derived from the sale of photographic and publishing products. Customers place Lifetouch product orders through the Lifetouch website, via paper order forms for school pictures, or in person at the JCPenney photo studios and churches. Customers pay using credit cards, or fill out an order form and enclose the required payment. The Company considers several indicators for the transfer of control to its customers, including the significant risks and rewards of ownership of products, the Company's right to payment, the legal title of the products, the physical possession of the products and the customer acceptance. Revenue is generally recognized upon shipment of the fulfilled orders, which occurs upon delivery to the carrier or when fulfilled orders arrive at studio locations and are available for customer pickup, which is the point of time control transfers to the customer.

SBS. The Company's SBS revenue is derived from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for its business customers. The services that the Company promises to its SBS customers are typically composed of a series of services that are performed over time. The Company accounts for these series of services as one performance obligation which represents a series of distinct services that are substantially the same and have the same pattern of transfer. The Company recognizes revenue from the satisfaction of performance obligations when it invoices its customers (that is, when it has the contractual right to bill under the contract). The Company has the contractual right to consideration from its customers in an amount that corresponds directly with the value to the customer of the services it has performed to date. For contracts that contain a significant non-refundable up-front fee, the Company considers whether these fees are related to the transfer of a promised good or service to the customer, and therefore represent a performance obligation. When the up-front fees do not represent a distinct performance obligation, the Company recognizes revenue ratably over the period for which there is a significant termination contractual penalty.

The Company relies upon the following practical expedients and exemptions allowed for in the revenue recognition accounting standard. The Company's incremental direct costs of obtaining a contract consist of Lifetouch and SBS sales commissions. The Company does not defer such incremental direct costs as the related performance obligations are satisfied within a short period of time and the Company elected to apply the practical expedient per ASC 340-40-25-4 related to expensing contract acquisition costs with the amortization period of less than one year. The Company does not provide any financing services to its customers. In addition, the Company does not disclose the value of unsatisfied performance obligations for (a) contracts with an original expected length of one year or less and (b) contracts for which it recognizes revenues at the amount to which it has the right to invoice for services performed.

Deferred Revenue

The Company records deferred revenue when cash payments are received in advance of the performance and primarily relate to flash deal promotions, gift cards, yearbooks and portrait proofs as well as up-front fees received from SBS customers. Flash deal promotions are purchased via third-party websites. The Company recognizes revenue on a gross basis, as the Company is primarily responsible for fulfilling the promise to provide the specified good or service, when redeemed items are shipped. The portion of flash deals that we do not expect to be redeemed is recognized as breakage revenue that is calculated based on customer redemption patterns.

Restructuring Costs

The Company records restructuring costs when expenses are incurred. The Company accrues for lease termination on the cease-use date (when the Company has completely vacated the space and the space is commercially available so that it can be subleased if and when a tenant becomes available). The Company accrues for severance once the total severance pool has been calculated, approved and communicated, and recognizes the expense ratably over the required service period, from the communication date to the exit date. The Company also accelerates depreciation and amortization using a revised economic life of property and equipment. Restructuring costs also include inventory markdowns, stock-based compensation and other costs incurred as part of restructuring.

Advertising Costs

Advertising costs are expensed as incurred, except for direct mail advertising which is expensed when the advertising first takes place. The Company did not have any material capitalized direct mail costs at December 31, 2018 and 2017. Total advertising costs are a component of sales and marketing expenses and include print advertising, Internet advertising, such as display ads and keyword search terms and TV and radio advertising. These amounts totaled approximately $175.7 million, $95.6 million and $122.1 million during the years ended December 31, 2018, 2017 and 2016, respectively.

Stock-Based Compensation

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

The Company estimates the fair value of stock options granted using the Black-Scholes valuation model. This model requires the Company to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of the Company's common stock price and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in the Company's consolidated statements of operations.

The cost of RSUs and performance-based restricted stock units ("PBRSUs") is determined using the fair value of the Company's common stock on the date of grant. Compensation expense is recognized for RSUs on a straight-line basis over the vesting period. Compensation expense associated with PBRSUs granted in previous years is recognized on an accelerated attribution model. As of December 31, 2017, the PBRSUs granted in previous years are only subject to service vesting conditions as the performance criteria has been met. In 2018, the Company granted PBRSUs that have both performance criteria tied to the Company's financial performance and a three-year service condition. Compensation expense associated with these PBRSUs is recognized based on the estimated number of shares the Company ultimately expects will vest and amortized on a straight-line basis over the requisite service period as these PBRSUs consist of only one tranche. If in the future, situations indicate that the performance criteria is not probable, then no further compensation cost will be recorded and any previous costs will be reversed.

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

Income Taxes

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

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

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

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

Net Income Per Share

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

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

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
	(in thousands, except per share amounts)		
NET INCOME PER SHARE			
NUMERATOR			
NET INCOME	**$50,396**	**$30,085**	**$15,906**
DENOMINATOR			
Denominator for basic net income per share			
Weighted-average common shares outstanding	33,258	33,113	34,097
Dilutive effect of stock options and restricted awards	1,367	993	1,093
Dilutive effect of convertible debt	207	—	—
DENOMINATOR FOR DILUTED NET INCOME PER SHARE	**34,832**	**34,106**	**35,190**
NET INCOME PER SHARE			
Basic	$ 1.52	$ 0.91	$ 0.47
DILUTED	**$ 1.45**	**$ 0.88**	**$ 0.45**

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

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
Stock options and RSUs	267	1,363	549

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources.

Comprehensive income is composed of net income (loss) and other comprehensive income (loss). The Company's other comprehensive income (loss) consists of unrealized gains and losses on marketable securities classified as available-for-sale, cumulative translation adjustments and unrealized gains and losses on cash flow hedges.

Segment Reporting

The Company reports as three reportable segments with the Chief Executive Officer acting as the Company's Chief Operating Decision Maker. The Company defined the reportable segments based on factors such as how management manages the operations and how its Chief Operating Decision Maker views results. The Company has the following reportable segments:

Shutterfly Consumer—Includes sales from the Company's Shutterfly, Tiny Prints and Groovebook brands, which are derived from the sale of a variety of products such as, cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and prints, and related shipping revenue, as well as rental revenue from its BorrowLenses brand. Revenue from advertising displayed on the Company's website is also included in Shutterfly Consumer revenue

Lifetouch—Includes revenue from professional photography services for schools, preschools and retail studios operated by Lifetouch under the JCPenney Portrait brand as well as churches and other groups.

SBS—Includes revenues from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for the Company's business customers.

Recently Adopted Accounting Pronouncements

In 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASC 606"). This new standard replaces all current GAAP guidance on this topic and eliminates all industry-specific guidance. The new revenue recognition guidance provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange of those goods or services. The Company adopted ASC 606 as of January 1, 2018 using the modified retrospective transition method. Refer to Note 3—*Revenue* for further details.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments.* The Company adopted ASU 2016-15 as of January 1, 2018 on a retrospective basis with no material impact to the consolidated statements of cash flows for the years ended December 31, 2018, 2017 and 2016. ASU 2016-15 clarifies how certain cash receipts and payments should be classified in the statement of cash flows, including the cash settlement for the convertible senior notes. Upon cash settlement in 2018, repayment of the principal amount was bifurcated between cash used in operating activities for the portion related to accreted interest attributable to debt discounts arising from the difference between the coupon interest rate and the effective interest rate, and financing activities for the remainder. As a result, $63.5 million of accreted interest was classified as cash used in operating activities in our consolidated statement of cash flows upon cash settlement for the year ended December 31, 2018.

In October 2016, the FASB issued ASU 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*. This standard addresses the recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset other than inventory. Prior to the adoption of ASU 2016-16, a company will defer for financial reporting purposes the income tax expense resulting from an intra-entity asset transfer, including the taxes currently payable or paid. Upon adoption of ASU 2016-16, a company will recognize current and deferred income taxes that result from such transfers in the period in which they occur. ASU 2016-16 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 and is applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The adoption of this standard during the year ended December 31, 2018, resulted in no cumulative-effect adjustment to the Company's accumulated deficit.

In August 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities ("ASU 2017-12"). The Company early adopted ASU 2017-12 during the third quarter of fiscal 2017 with no impact to the financial statements as the Company did not have existing hedging relationships or other derivative instruments in place within the scope of ASC 815 prior to the third quarter of fiscal 2017.

In March 2016, the FASB issued ASU 2016-09, Compensation—Stock Compensation (Topic 718):

Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). The updated guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted ASU 2016-09 beginning January 1, 2017 and the impact of adoption resulted in the following:

- The Company recorded approximately $23.2 million of additional deferred tax assets with the corresponding decrease to accumulated deficit related to the prior years' unrecognized excess tax benefits (adoption method was modified retrospective).
- The Company recorded a tax benefit of $1.1 million as a discrete item within income tax benefit for the year ended December 31, 2017 related to the excess tax benefit on stock options, restricted stock and performance share units. Prior to adoption this amount would have been recorded as a reduction of additional paid-in capital. This change could create volatility in the Company's future effective tax rate.
- The Company elected not to change its policy on accounting for forfeitures and will continue to estimate the total number of awards for which the requisite service period will not be rendered.
- The Company no longer reclassifies the excess tax benefit from operating activities to financing activities in the statement of cash flows. The Company elected to apply this change in presentation prospectively and therefore, prior periods have not been adjusted.
- The remaining provisions of ASU 2016-09 did not have a material impact on the accompanying consolidated financial statements.

Recent Accounting Pronouncements Pending Adoption

In August 2018, the FASB issued ASU 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* ("ASU 2018-15"), which clarifies the accounting for implementation costs in cloud computing arrangements. ASU 2018-15 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019, and earlier adoption is permitted including adoption in any interim period. The Company is evaluating the impact of adopting this new accounting guidance on the consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement, Reporting Comprehensive Income (Topic 220): Reclassification of Certain Effects from Accumulated Other Comprehensive Income* ("ASU 2018-02"), which allows a reclassification of stranded tax effects from accumulated other comprehensive income to retained earnings, as a result of the Tax Act. ASU 2018-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted and can be applied either in the period of adoption or retrospectively to all applicable periods. The Company does not expect that the pending adoption of ASU 2018-02 will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350)*. The updated guidance simplifies the measurement of goodwill impairment by removing step two of the goodwill impairment test, which requires the determination of the fair value of individual assets and liabilities of a reporting unit. The new guidance requires goodwill impairment to be measured as the amount by which a reporting unit's carrying value exceeds its fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendments should be applied on a prospective basis. The new standard is effective for annual or any interim goodwill impairment tests performed in fiscal years beginning after December 15, 2019 with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is evaluating the impact this new accounting guidance will have on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which requires measurement and recognition of expected credit losses for financial assets held. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Earlier adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

The Company is evaluating the impact of adopting this new accounting guidance on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This new standard requires lessees to recognize operating leases with a term greater than one year on the balance sheet as a right-of-use asset and corresponding lease liability, measured at the present value of the future lease payments. The standard will be effective for the Company beginning on January 1, 2019. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842) Targeted Improvements*, which allows for the adoption of this standard to be applied at the beginning of the most recent fiscal year as opposed to at the beginning of the earliest year presented. The Company plans to adopt under the provisions allowed under ASU 2018-11 and accordingly will adopt the standard as of January 1, 2019. The Company will apply the transition option, whereby prior comparative periods will not be retrospectively presented in the consolidated financial statements. The Company will elect the package of practical expedients permitted under the transition guidance, which allows the Company to carry forward its historical lease classification, its assessment on whether a contract is or contains a lease, and its initial direct costs for any leases that exist prior to adoption of the new standard. The Company will not elect the hindsight practical expedient, which permits the use of hindsight when determining lease term and impairment of right-of-use assets. Further, the Company will elect a short-term lease exception policy, permitting the Company to not apply the recognition requirements of this standard to short-term leases (i.e. leases with terms of 12 months or less).

The Company is finalizing the evaluation of the effects on its Consolidated Financial Statements and disclosures. The Company expects the most significant impact relates to its leases currently designated as operating leases and disclosed on an undiscounted basis in Note 9—*Commitments and Contingencies* that will be recognized as right-of-use assets and corresponding lease liabilities on its Consolidated Balance Sheet on January 1, 2019. Additionally, the Company expects to derecognize all of its build-to-suit arrangements on January 1, 2019 upon adoption as they will no longer qualify for build-to-suit accounting and will instead be recognized as operating leases under ASC 842. As a result, the Company will derecognize approximately $48.0 million in building assets and approximately $54.0 million in financing obligations upon the adoption of the new lease standard on January 1, 2019. For these leased assets specifically, the Company will recognize approximately $23.0 million in right-of-use assets and approximately $33.0 million in lease liabilities on its Consolidated Balance Sheets on January 1, 2019. This change will also impact certain expenses in the Company's Consolidated Statement of Operations where the Company expects depreciation expense, reflected as part of cost of net revenue, and interest expense will decrease by approximately $2.0 million and $4.0 million, respectively, and its lease expense reflected as part of cost of net revenue will increase by approximately $5.0 million for the year ending December 31, 2019.

Note 3—Revenue

Adoption of ASC 606, Revenue from Contracts with Customers

The Company adopted ASC 606 as of January 1, 2018 using the modified retrospective transition method. Under the modified retrospective method, ASC 606 is only applied to contracts that were not complete as of the adoption date. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC 605, *Revenue Recognition*.

As a result of the adoption of ASC 606, the Company identified an impact related to timing and measurement of breakage revenue for the Shutterfly Consumer and the Lifetouch businesses and for one of the Company's significant multiple performance obligation arrangements in connection with the SBS business. Upon adoption of ASC 606, the Company recognized the expected breakage amounts as revenue in proportion to the pattern of rights exercised by the customer, rather than the previous method of recognizing breakage revenue when the Company believed the redemption was remote. As it relates to timing and measurement of one of the Company's multiple performance obligation arrangements in connection with the SBS business, deferred revenue was previously recognized over the stated term of the contract. Upon adoption of ASC 606, deferred revenue for this particular arrangement is now recognized ratably over a period of time that is shorter than the stated contract term, as this arrangement does not contain substantive termination

penalties after a certain initial number of years within the contractual term.

The cumulative impact of the adoption of ASC 606 resulted in a decrease to opening accumulated deficit of $4.2 million as of January 1, 2018, which consisted of a decrease in total liabilities of $5.1 million primarily related to deferred revenue and a decrease in total assets of $0.9 million primarily related to deferred costs.

The impact as a result of applying ASC 606 was:

- an increase of $2.3 million to net revenue for the year ended December 31, 2018; and
- a decrease to deferred revenue of $8.6 million as of December 31, 2018.

The impact to other accounts is not material as of December 31, 2018 and for the year ended December 31, 2018.

Deferred Revenue

The Company's total deferred revenue was $58.1 million and $30.3 million as of December 31, 2018 and 2017, respectively. The increase of $27.8 million in deferred revenue balance during the year ended December 31, 2018 is primarily driven by the deferred revenue from the acquisition of Lifetouch (deferred revenue balance as of December 31, 2018 for Lifetouch was $36.8 million) and by cash payments received in advance of the Company's performance obligations during the year ended December 31, 2018. The increase is offset by the impact of ASC 606 adoption and $5.4 million of revenue recognized that was included in deferred revenue balance as of December 31, 2017.

Net Revenue by Brand

The following table disaggregates the Company's net revenue by brand for the years ended December 31, 2018, 2017 and 2016 (in thousands):

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
Shutterfly consumer net revenue:			
Shutterfly Brand Core	$ 689,700	$ 661,682	$ 605,500
Shutterfly Brand Personalized Gifts and Home Décor	201,143	182,560	157,430
Tiny Prints Boutique(1)	45,556	50,874	—
Tiny Prints(1)	—	23,382	128,557
Wedding Paper Divas(2)	—	34,178	51,429
MyPublisher(3)	—	10,992	20,492
Other	35,430	33,295	34,148
SHUTTERFLY CONSUMER NET REVENUE	**971,829**	**996,963**	**997,556**
Lifetouch net revenue(4)	759,403	—	—
SBS net revenue	230,588	193,239	136,668
NET REVENUE	**$1,961,820**	**$1,190,202**	**$1,134,224**

(1) On June 28, 2017, the Company created a Tiny Prints boutique on a dedicated tab on Shutterfly.com and shut down the legacy Tiny Prints website.

(2) On September 13, 2017, the Company launched the new Shutterfly Wedding Shop and shut down the Wedding Paper Divas legacy website.

(3) The MyPublisher brand was shut down on May 15, 2017.

(4) On April 2, 2018, the Company acquired Lifetouch.

Note 4—Acquisition

On January 30, 2018, the Company entered into a Stock Purchase Agreement (the "Purchase Agreement") with Lifetouch and Lifetouch Inc. Employee Stock Ownership Trust (collectively, the "Seller"). On April 2, 2018, pursuant to the Purchase Agreement, the Company completed the acquisition of 100% of the issued and outstanding shares of common stock of Lifetouch from the Seller. Under the terms of the Purchase Agreement, the consideration for the acquisition consisted of an all-cash purchase price of $825.0 million subject to certain adjustments based on a determination of Closing Net Working Capital, Transaction Expenses, Cash and Investments, and Closing Indebtedness, as defined in the Purchase Agreement. The Company financed the all-cash purchase price with an incremental $825.0 million term loan issuance under its existing credit agreement, which closed simultaneous with the acquisition *(refer to Note 14—Debt for further details).*

Lifetouch provides the Company with a highly complementary business. Lifetouch will offer Shutterfly's broader product range to Lifetouch customers, as well as to accelerate the development of Lifetouch's online order-taking platform. The Company expects to gain access to many Lifetouch customers as Shutterfly customers, where they will benefit from Shutterfly's leading cloud-based photo management service, product creation capabilities, mobile apps, and broad product range.

The Company elected to treat the acquisition of Lifetouch as an asset acquisition under section 338(h)(10) of the U.S. Internal Revenue Service tax code. As such, the goodwill that the Company recognizes as part of the Lifetouch acquisition will be deductible for U.S. income tax purposes. The goodwill recognized represents the assembled workforce of Lifetouch and the value of growth in revenue from future customers of Lifetouch.

During the year ended December 31, 2018, the Company recorded approximately $15.5 million of direct and incremental costs associated with acquisition-related activities. These costs were incurred primarily for banking, legal, professional fees and personnel-related costs for transitional employees associated with the Lifetouch acquisition. These costs were recorded in general and administrative expenses in the consolidated statement of operations.

During the year ended December 31, 2018, Lifetouch had $759.4 million of net revenue, and $442.4 million of gross profit.

Under the terms of the Purchase Agreement, the amount of consideration that the Company paid consisted of an all-cash purchase price of $825.0 million subject to certain adjustments based on a determination of Closing Net Working Capital, Transaction Expenses, Cash and Investments, and Indebtedness, each term as defined by the Purchase Agreement. The total purchase consideration paid by the Company during the second quarter of 2018 was $982.0 million. The following table shows the calculation of how the purchase consideration paid by the Company was determined in accordance with the Purchase Agreement (in thousands):

Cash consideration at closing	$ 825,000
Less: Closing indebtedness(1)	(27,742)
Less: Closing net working capital adjustment(1)	(10,559)
Less: Transaction expenses(1)(2)	(17,614)
Add: Closing cash and Investments(1)	212,872
Purchase price adjustments	156,957
TOTAL PURCHASE CONSIDERATION	**$981,957**

(1) As defined in the Purchase Agreement.

(2) Transaction expenses incurred by Lifetouch in connection with the transaction as defined by the Purchase Agreement.

In accordance with ASC 805, *Business Combinations,* the Company has recorded the acquired assets (including identifiable intangible assets) and liabilities assumed at the acquisition date fair values. The purchase price allocation for the Lifetouch acquisition is preliminary and subject to revision as additional information about fair value of assets acquired and liabilities assumed becomes available. Additional information that existed as of the acquisition date but at that time was unknown may become known during the remainder of the measurement period, a period not to exceed 12 months from the acquisition date. The primary areas that remain preliminary relate to the fair value of intangible assets acquired, property and equipment and certain liabilities acquired.

The following table shows the preliminary allocation of the total purchase price to the net assets acquired based on their estimated fair values as of April 2, 2018 (in thousands):

Cash and cash equivalents	$ 91,753
Investments	100,574
Accounts receivable	7,680
Inventories	19,857
Property and equipment	134,973
Intangible assets	326,300
Goodwill	434,862
Prepaid expenses and other assets	37,037
Accounts payable	(9,388)
Deferred revenue, current portion	(31,334)
Notes payable	(9,102)
Accrued and other liabilities	(121,255)
TOTAL	**$981,957**

The following table shows the valuation of the intangible assets acquired from Lifetouch along with their estimated useful lives:

	APPROXIMATE FAIR VALUE (IN THOUSANDS)	WEIGHTED AVERAGE LIFE (IN YEARS)
Customer contracts and related relationships	$ 200,400	10
Developed technology	68,000	5
Trade names / trademarks / domain name	57,600	5
Favorable/unfavorable leases	300	7
TOTAL INTANGIBLE ASSETS	**$326,300**	

Identifiable Intangible Assets

Customer contracts and related relationships. These assets primarily relate to the existing relationships that Lifetouch has developed with a number of schools and preschools. These relationships provide economic value to the Company and therefore were valued separately from goodwill. The Company valued these assets utilizing a form of the income approach known as the "Multi-Period Excess Earnings Method" ("MPEEM") since these customer assets were identified as the primary asset. Under the MPEEM, the value of these assets was estimated based on the expected future economic earnings attributable to the assets. The key assumptions used in the valuation of these assets include future revenue from existing customers and estimated expenses forecast, contributory asset charges (such as cash-free debt-free working capital, fixed assets, brand assets and assembled workforce), the discount rate, expected tax rate(s) and tax amortization benefit.

Developed technology. Lifetouch has a number of developed technology platforms that are internally-used (e.g., field operations management and production management systems) and customer-facing (e.g., order management and yearbook design systems). These technologies will continue to be used by the Company. Given that the technologies are specific to Lifetouch and have minimal possibility of being licensed out to third parties, the "Cost to Recreate Method" under the Cost approach was used to value these assets. The key assumptions used in the valuation of these assets include direct and indirect developer costs, developer's profit, and opportunity cost.

Trade names / trademarks / domain name. Lifetouch is the leading provider of school photography services in the United States and has a number of registered trade names, trademarks and domain names that are recognized and well known in the marketplace. These brand names are expected to continue to be used, providing economic value to the Company, and therefore were valued separately from goodwill. The "Relief from Royalty Method" of the income approach was used in the valuation of trade names, trademarks and domain names.

Unaudited Pro Forma Financial Information

The following table summarizes the pro forma consolidated information for the Company assuming the acquisition of Lifetouch had occurred as of January 1, 2017. The unaudited pro forma information for all periods presented includes the business combination accounting effects resulting from the acquisition, including amortization for intangible assets acquired, depreciation expense for tangible assets acquired, interest expense for the additional indebtedness incurred to complete the acquisition, acquisition-related charges and the impact of adopting ASC 606. The impact of applying ASC 606 to Lifetouch's historical periods as presented below was not material. The pro forma results also include the effects of the purchase accounting adjustments for the fair value of deferred revenue and inventory. The unaudited pro forma financial information as presented below is for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of fiscal 2017.

	YEAR ENDED DECEMBER 31,	
	2018	2017
	(in thousands, except per share data)	
Total net revenue	$2,135,604	$2,131,164
Net income (loss)	$ 41,869	$ (15,841)
Basic income (loss) per share	$ 1.26	$ (0.48)
Diluted income (loss) per share	$ 1.20	$ (0.48)

Note 5—Balance Sheet Components

Property and Equipment, Net

	DECEMBER 31,	
	2018	2017
	(in thousands)	
Computer equipment and software	$ 347,032	$ 323,178
Plant and equipment	297,597	211,702
Land, buildings and building improvements	113,048	56,468
Leasehold improvements	27,011	22,145
Furniture, fixtures and other	11,498	8,255
	796,186	621,748
Less: Accumulated depreciation and amortization	(415,168)	(354,888)
PROPERTY AND EQUIPMENT, NET	**$381,018**	**$266,860**

Included within computer equipment and software is approximately $75.3 million and $57.4 million of capitalized software and website development costs, net of accumulated amortization at December 31, 2018 and December 31, 2017, respectively. Amortization of capitalized costs totaled approximately $29.9 million, $26.8 million and $22.0 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Plant and equipment includes manufacturing, photography, and rental equipment. Rental equipment includes camera lenses, camera bodies, video equipment and other camera peripherals which are rented through the BorrowLenses website. Included within plant and equipment is approximately $92.5 million and $89.9 million of capital lease obligations for various pieces of manufacturing facility equipment as of December 31, 2018 and December 31, 2017, respectively. Accumulated depreciation of assets under capital lease totaled $44.9 million and $32.4 million at December 31, 2018 and December 31, 2017, respectively.

Included within land, buildings and building improvements is approximately $56.5 million of build-to-suit arrangements which represents the estimated fair market value of buildings under build-to-suit arrangements of which the Company is the "deemed owner" for accounting purposes only. See *Note 9—Commitments and Contingencies* for further discussion of the Company's build-to-suit arrangements.

Included in property and equipment is approximately $26.3 million and $15.8 million of assets in construction as of December 31, 2018 and December 31, 2017, respectively, the majority of which relates to computer equipment and software.

Depreciation and amortization expense totaled $110.7 million, $88.9 million, and $93.5 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Intangible Assets

Intangible assets are comprised of the following:

	WEIGHTED AVERAGE USEFUL LIFE	DECEMBER 31, 2018	2017
		(in thousands)	
Customer relationships	9 years	$ 275,546	$ 75,146
Less: accumulated amortization		(91,087)	(73,759)
		184,459	1,387
Purchased technology	5 years	121,769	53,769
Less: accumulated amortization		(64,142)	(53,732)
		57,627	37
Trade name	9 years	112,120	54,520
Less: accumulated amortization		(38,320)	(26,273)
		73,800	28,247
Other	2 years	4,097	3,782
Less: accumulated amortization		(3,829)	(3,782)
		268	—
TOTAL	**8 years**	**$316,154**	**$29,671**

Acquired intangible asset amortization expense for the years ended December 31, 2018, 2017 and 2016 was $39.3 million, $13.7 million and $18.9 million, respectively. Amortization of acquired intangible assets is estimated to be as follows (in thousands):

YEAR ENDED DECEMBER 31:	
2019	$ 49,648
2020	48,901
2021	48,773
2022	48,082
2023	29,302
Thereafter	91,448
	$316,154

Goodwill

The Company conducted its annual impairment assessment test during the fourth quarter of 2018 in accordance with authoritative guidance. Based on the qualitative assessment, the Company determined that the estimated fair values of all of the reporting units substantially exceeded their carrying values and that they were not impaired. Accordingly, there was no indication of impairment, and further quantitative testing was not required.

The following table presents the goodwill allocated to the Company's reportable segments as of and during the year ended December 31, 2018 (in thousands):

	DECEMBER 31, 2017	ACQUISITIONS	TRANSLATION ADJUSTMENTS	DECEMBER 31, 2018
Shutterfly Consumer	$ 372,072	$ —	$ —	$ 372,072
Lifetouch	—	434,862	(230)	434,632
Shutterfly Business Solutions	36,903	—	—	36,903
	$408,975	**$434,862**	**$(230)**	**$843,607**

Accrued Liabilities

	DECEMBER 31,	
	2018	2017
	(in thousands)	
Accrued production costs	$ 46,497	$ 37,552
Accrued compensation	44,720	31,331
Accrued marketing expenses	36,428	22,874
Accrued income, sales and other taxes	28,886	21,745
Capital lease obligations, current portion	14,741	16,859
Accrued professional services	11,988	7,786
Accrued other	43,185	21,101
	$226,445	**$159,248**

Other Liabilities

	DECEMBER 31,	
	2018	2017
	(in thousands)	
Financing obligations	$ 51,732	$ 53,682
Capital lease obligations, non-current portion	38,576	48,620
Deferred tax liability	7,110	1,012
Other liabilities	36,609	15,881
	$134,027	**$119,195**

Financing obligations relate to the Company's build-to-suit arrangements as further discussed in *Note 9—Commitments and Contingencies*.

Note 6—Investments

At December 31, 2018 and 2017, the estimated fair value of short-term and long-term investments classified as available for sale are as follows (in thousands):

	DECEMBER 31, 2018			
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
SHORT-TERM INVESTMENTS				
Corporate debt securities	$ 24,367	$—	$ (43)	$ 24,324
Agency securities	5,728	—	(19)	5,709
U.S. government securities	3,986	—	(8)	3,978
TOTAL SHORT-TERM INVESTMENTS	**$34,081**	**$—**	**$(70)**	**$34,011**
LONG-TERM INVESTMENTS				
Corporate debt securities	$ 4,283	$—	$ (13)	$ 4,270
Agency securities	2,113	—	(7)	2,106
U.S. government securities	4,445	—	(13)	4,432
TOTAL LONG-TERM INVESTMENTS	**$10,841**	**$—**	**$(33)**	**$10,808**

	DECEMBER 31, 2017			
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
SHORT-TERM INVESTMENTS				
Corporate debt securities	$ 54,911	$ 3	$ (52)	$ 54,862
Agency securities	10,781	—	(14)	10,767
Commercial paper	101,546	—	—	101,546
U.S. Government securities	10,857	—	(11)	10,846
TOTAL SHORT-TERM INVESTMENTS	**$178,095**	**$ 3**	**$(77)**	**$178,021**
LONG-TERM INVESTMENTS				
Corporate debt securities	$ 6,287	$—	$ (25)	$ 6,262
Agency securities	2,000	—	(17)	1,983
U.S. government securities	998	—	(1)	997
TOTAL LONG-TERM INVESTMENTS	**$ 9,285**	**$—**	**$(43)**	**$ 9,242**

The Company had no available-for-sale investments with a significant unrealized loss that have been in a continuous unrealized loss position for more than 12 months as of December 31, 2018, 2017 and 2016 and no impairments were recorded in the respective periods. The Company had no material realized gains or losses during the years ended December 31, 2018 and 2017.

The following table summarizes the contractual maturities of the Company's investments as of December 31, 2018 and 2017 (in thousands):

	DECEMBER 31,	
	2018	2017
One year or less	$ 34,011	$ 178,021
One year through three years	10,808	9,242
	$44,819	**$187,263**

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

Note 7—Fair Value Measurement

Cash Equivalents and Investments

The Company measures the fair value of money market funds and investments based on quoted prices in active markets for identical assets or liabilities. All other financial instruments were valued either based on recent trades of securities in inactive markets or based on quoted market prices of identical or similar instruments and other significant inputs derived from or corroborated by observable market data. The Company did not hold any cash equivalents or investments categorized as Level 3 as of December 31, 2018.

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

	TOTAL ESTIMATED FAIR VALUE AS OF			
	DECEMBER 31, 2018		DECEMBER 31, 2017	
	CASH EQUIVALENTS	INVESTMENTS	CASH EQUIVALENTS	INVESTMENTS
LEVEL 1 SECURITIES:				
Money market funds	$ 116,212	$ —	$ 151,071	$ —
LEVEL 2 SECURITIES:				
Corporate debt securities	—	28,594	21,592	61,124
Agency securities	—	7,815	6,444	12,750
U.S. Government securities	—	8,410	—	11,843
Commercial Paper	—	—	85,599	101,546
TOTAL CASH EQUIVALENTS AND INVESTMENTS	**$116,212**	**$44,819**	**$264,706**	**$187,263**

Derivative Assets

As of December 31, 2018 and 2017, the fair value of the interest-rate swap agreements, which were determined based on an income-based valuation model that takes into account the contract terms as well as multiple observable market inputs such as LIBOR-based yield curves, futures, volatility and basis spreads (Level 2), were as follows (in thousands):

	TOTAL ESTIMATED FAIR VALUE AS OF	
	DECEMBER 31, 2018	DECEMBER 31, 2017
DERIVATIVE ASSETS	**$4,204**	**$2,979**

Borrowings

As of December 31, 2018, and 2017, the fair value of the Company's borrowings, which were determined based on inputs that are observable in the market or that could be derived from, or corroborated with, observable market data, including the Company's stock price, interest rates and credit spread (Level 2) were as follows (in thousands):

	TOTAL ESTIMATED FAIR VALUE AS OF	
	DECEMBER 31, 2018	DECEMBER 31, 2017
Convertible senior notes	$ —	$296,550
Term loans	1,081,520	300,000

The carrying value of other financial instruments, including accounts receivable, accounts payable, assumed notes from the acquisition of Lifetouch and other payables, approximates fair value due to their short maturities.

Note 8—Derivative Financial Instruments

In August 2017, the Company entered into certain interest-rate swap agreements ("Swap Agreements") with an aggregate notional amount of $150.0 million and an effective date of October 18, 2017. The Swap Agreements have the economic effect of modifying a portion of the variable interest-rate obligations associated with the Company's Initial Term loan ("Term Loan") drawn in October 2017 so that the interest payable on such portion of the Initial Term Loan become fixed at a rate of 4.27% (refer to Note 14—*Debt* for further details regarding the term loan facility). The Swap Agreements have a maturity date of August 17, 2023 as compared to August 17, 2024 for the Initial Term Loan. Further, the Initial Term Loan has an interest-rate floor, whereas the Swap Agreements do not include a floor. All other critical terms of the Swap Agreements correspond to the Initial Term Loan, including interest-rate reset dates and underlying market indices. The Company fully drew the Initial Term Loan on October 18, 2017 which is also the effective date of the Swap Agreements. The Company has asserted that it is probable that it will have sufficient outstanding debt throughout the life of the Swap Agreements.

The Company has designated the aforementioned Swap Agreements as qualifying hedging instruments and is accounting for them as cash flow hedges pursuant to ASC 815 (as amended by ASU 2017-12).

The fair value of the Swap Agreements was $4.2 million and $3.0 million as of December 31, 2018 and December 31, 2017, respectively and were classified as other assets in the balance sheet. The unrealized gains (losses) recognized in other comprehensive income (loss) were $1.2 million and $3.0 million, for the years ended December 31, 2018 and 2017, respectively. The amounts reclassified from other comprehensive income (loss) to interest expense during the years ended December 31, 2018 and 2017 were insignificant. Amounts expected to be reclassified from other comprehensive income into interest expense in the coming 12 months is $1.1 million. Interest expense (including the effects of the cash flow hedges) related to the portion of the Initial Term Loan subject to the aforementioned interest-rate swap agreements was $7.0 million and $1.3 million for the years ended December 31, 2018 and 2017, respectively.

The Company does not use derivative financial instruments for trading purposes.

Note 9—Commitments and Contingencies

Leases

The Company leases certain equipment, office space, production and warehouse facilities and several photographic studios under various non-cancelable operating leases that expire on various dates through 2030. The future minimum payments of non-cancelable operating leases assumed in connection with the acquisition of Lifetouch in 2018 amount to $39.4 million at December 31, 2018. The Company's rent expense was $20.2 million, $7.1 million and $6.1 million, for the years ended December 31, 2018, 2017 and 2016, respectively.

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

The Company has production equipment under capital leases. During the year ended December 31, 2018, the Company entered into new equipment leases with terms which resulted in capital lease treatment.

At December 31, 2018, the total future minimum payments under non-cancelable operating and capital leases are as follows (in thousands):

	OPERATING LEASES	CAPITAL LEASES
YEAR ENDING DECEMBER 31,		
2019	$ 23,557	$ 16,853
2020	17,730	10,582
2021	13,763	9,908
2022	9,928	9,820
2023	1,872	8,237
Thereafter	1,501	4,023
TOTAL MINIMUM LEASE PAYMENTS	**$68,351**	**$59,423**
LESS: AMOUNT REPRESENTING INTEREST		**(6,106)**
Present value of future minimum lease payments		53,317
Less: current portion		14,741
NON-CURRENT PORTION OF CAPITAL LEASE OBLIGATIONS		**$38,576**

Total future minimum sublease income to be received from non-cancelable leases is $0.6 million as of December 31, 2018.

Purchase obligations consist of non-cancelable marketing and service agreements and co-location services that expire at various dates through the year 2023. As of December 31, 2018, the Company's purchase obligations totaled $80.6 million. At December 31, 2018, the total future minimum payments under these purchase obligations are as follows (in thousands):

YEAR ENDING DECEMBER 31,	
2019	$ 51,033
2020	27,293
2021	1,401
2022	465
2023	447
TOTAL MINIMUM PURCHASE OBLIGATIONS	**$80,639**

Build-to-suit Arrangement

The Company completed the following construction of facilities in prior years:

Fort Mill, South Carolina: During the year ended December 31, 2012, the Company executed a lease for a 300,000 square foot east coast production and customer service facility in Fort Mill, South Carolina. The Company concluded it was the "deemed owner" of the building (for accounting purposes only) and completed the construction of this facility in 2013. The Company initially recorded an asset and corresponding financing obligation of $4.9 million which was increased by $3.1 million and $1.5 million for building uplift costs incurred during 2013 and 2012, respectively.

Shakopee, Minnesota: During the year ended December 31, 2013, the Company executed a lease for a 217,000 square foot production facility in Shakopee, Minnesota. The Company concluded it was the "deemed owner" of the building (for accounting purposes only) and completed the construction of this facility in 2014. The Company recorded an asset and corresponding financing obligation of $13.7 million and $7.0 million for building uplift costs incurred during 2014 and 2013, respectively.

Tempe, Arizona: During the year ended December 31, 2013, the Company executed a lease for a 237,000 square foot production facility in Tempe, Arizona. The Company concluded it was the "deemed owner" of the building (for accounting purposes only) and completed the construction of this facility in 2015. The Company recorded an asset and corresponding financing obligation of $17.2 million and $9.1 million for building construction costs incurred during 2015 and 2014, respectively.

At the time of completion of each facility, the Company evaluated the de-recognition of the asset and liability under the provisions of ASC 840 Leases. If the Company did not comply with the provisions needed for sale-leaseback accounting, the lease was accounted for as a financing obligation and lease payments were attributed to (1) a reduction of the principal financing obligation; (2) imputed interest expense; and (3) land lease expense (which is considered an operating lease and a component of cost of goods sold) representing an imputed cost to lease the underlying land of the facility. In addition, the underlying building asset was depreciated over the building's estimated useful life which is generally 30 years. And at the conclusion of the lease term, the Company would de-recognize both the net book values of the asset and financing obligation.

The Company concluded that it had forms of continued economic involvement in all three of the facilities. As a result, the Company did not comply with provisions for sale-leaseback accounting and the buildings are being accounted for as a financing obligation.

At December 31, 2018, the total future rent payments under these build-to-suit arrangements are as follows (in thousands):

YEAR ENDING DECEMBER 31,	
2019	$ 6,501
2020	6,646
2021	6,794
2022	6,947
2023	6,479
Thereafter	6,522
TOTAL FUTURE RENT PAYMENTS UNDER BUILD-TO-SUIT ARRANGEMENTS	**$39,889**

Indemnifications

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

Letter of credit

As of December 31, 2018, the Company has stand-by letters of credit, totaling approximately $18.7 million, for the benefit of the Company's workers' compensation insurance carriers. There were no amounts drawn against any of the letters of credit at December 31, 2018. The letters of credit are secured by collateral in the form of a certificate of deposit, which is treated as restricted other current asset and is recorded in other current assets on the balance sheet.

Contingencies

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

Legal Matters

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

Monroy v. Shutterfly, Inc.

On November 30, 2016, Alejandro Monroy on behalf of himself and all others similarly situated, filed a complaint against Shutterfly in the U.S. District Court for the Northern District of Illinois. The complaint asserts that Shutterfly violated the Illinois Biometric Information Privacy Act by extracting his and others' biometric identifiers from photographs and seeks statutory damages and an injunction. The Company believes the suit is without merit and intends to vigorously defend against it.

Taylor v. Shutterfly, Inc.

On December 12, 2017, Megan Taylor filed a purported class action complaint on behalf of herself and other customers in the U.S. District Court for the Northern District of California. Taylor alleges that Shutterfly misrepresents a deal it currently offers through Groupon because it does not allow purchasers of the Groupon offer to combine or "stack" it with other promotional codes offered by Shutterfly. Taylor is seeking monetary damages and injunctive relief. The

Company believes the suit is without merit and intends to vigorously defend against it.

Vigeant v Meek et al.

On March 1, 2018, a purported class action complaint was filed against several directors of Lifetouch, Inc. (which became a direct wholly-owned subsidiary of Shutterfly on April 2, 2018) and the trustee of the Lifetouch Employee Stock Ownership Plan (the "ESOP") in the U.S. District Court for the District of Minnesota (the "District Court"). On April 2, 2018, the complaint was amended to include the prior ESOP trustees and plan sponsor (Lifetouch) as additional named defendants. On November 7, 2018, the District Court granted defendant's motion to dismiss in its entirety and with prejudice. Plaintiffs' counsel filed a timely notice of appeal with the 8th Circuit Court of Appeals. The complaint alleges violations of the Employee Retirement Income Security Act, including that the ESOP should not have been permitted to continue investing in Lifetouch stock during a period in which the Lifetouch stock price was declining. The plaintiffs seek recovery for damages arising from the alleged breaches of fiduciary duty. The Company believes this suit is without merit and intends to vigorously defend against it.

In all cases, at each reporting period, the Company evaluates whether a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses accounting for contingencies. In such cases, the Company accrues for the amount, or if a range, the Company accrues the low end of the range as a component of legal expense. The Company monitors developments in these legal matters that could affect the estimate the Company had previously accrued. There are no amounts accrued which the Company believes would be material to its financial position, liquidity, and results of operations.

Note 10—Stock-Based Compensation

2006 Equity Incentive Plan

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

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

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

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

Tiny Prints 2008 Equity Incentive Plan

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

2015 Equity Incentive Plan

In December 2015 the Company's stockholders approved, the 2015 Plan, and all shares of

common stock available for grant under the 2006 Plan transferred to the 2015 Plan. The types of awards under the 2015 Plan include restricted stock awards, stock bonus awards, restricted stock units, and performance shares. The 2015 Plan provides for 1,400,000 shares of the Company's common stock available for issuance in addition to the shares available under the 2006 plan. The 2015 Plan was amended in 2017 and 2018 to increase the number of shares available for issuance by 1,300,000 and 900,000 shares, respectively.

Stock Option Activity

A summary of the Company's stock option activity at December 31, 2018 and changes during the period are presented in the table below (share numbers and aggregate intrinsic values in thousands):

	NUMBER OF OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE	WEIGHTED AVERAGE CONTRACTUAL TERM (YEARS)	AGGREGATE INTRINSIC VALUE
Balance, December 31, 2017	1,529	$ 46.77		
Granted	342	73.04		
Exercised	(439)	45.96		
Forfeited, canceled or expired	(27)	45.49		
BALANCE, DECEMBER 31, 2018	**1,405**	**$53.44**	**5.1**	**$216**
OPTIONS VESTED AND EXPECTED TO VEST AS OF DECEMBER 31, 2018	**1,309**	**$52.91**	**5.0**	**$216**
OPTIONS VESTED AS OF DECEMBER 31, 2018	**439**	**$47.31**	**4.4**	**$216**

As of December 31, 2017, and 2016, there were 401,000 and 100,000 options vested, respectively.

During the year ended December 31, 2018, the Company granted options to purchase an aggregate of 342,000 shares of common stock at a weighted average exercise price of $73.04, with an estimated weighted-average grant-date fair value of $22.29. The total intrinsic value of options exercised during the years ended December 31, 2018, 2017 and 2016 was $13.5 million, $0.9 million, and $2.8 million, respectively. Net cash proceeds from the exercise of stock options were $20.2 million, $0.7 million, and $2.1 million for the years ended December 31, 2018, 2017 and 2016, respectively. The total grant date fair value of stock options vested during the years ended December 31, 2018, 2017 and 2016 was $6.2 million, $4.5 million, and $0.1 million, respectively.

Valuation of Stock Options

The Company estimated the fair value of each option award on the date of grant using the Black-Scholes option-pricing model. The Company calculated volatility using an average of its historical and implied volatilities as it had sufficient public trading history to cover the entire expected term. The expected term of options gave consideration to historical exercises, post-vest cancellations and the options contractual term. The risk-free rate for the expected term of the option is based on the U.S. Treasury Constant Maturity at the time of grant. The assumptions used to value options granted during the years ended December 31, 2018, 2017 and 2016 are as follows:

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
Dividend yield	—	—	—
Annual risk-free rate of return	2.7%	1.9%	1.2%
Expected volatility	33.2%	29.8%	32.9%
Expected term (years)	4.1	4.1	4.1

Restricted Stock Units

The Company grants restricted stock units ("RSUs") and performance-based restricted stock units ("PBRSUs") to its employees under the provisions of the 2015 Plan and inducement awards to certain new employees upon hire in accordance with Nasdaq Listing Rule 5635(c)(4). The cost of RSUs is determined using the fair value of the Company's common stock on the date of grant. RSUs typically vest and are settled annually, based on a four-year total vesting term. Compensation cost associated with RSUs is amortized on a straight-line basis over the requisite service period. Compensation expense associated with PBRSUs granted in previous years is recognized on an accelerated attribution model. As of December 31, 2018, the PBRSUs granted in previous years are only subject to service vesting conditions as the performance criteria have been met.

In 2018, the Company granted PBRSUs that have both performance criteria tied to the Company's financial performance and a three-year service condition. Compensation cost associated with these PBRSUs is recognized based on the estimated number of shares the Company ultimately expects will vest and amortized on a straight-line basis over the requisite service period as these PBRSUs consist of only one tranche. If in the future, situations indicate that the performance criteria is not probable, then no further compensation cost will be recorded and any previous costs will be reversed.

Restricted Stock Unit Activity

A summary of the Company's restricted stock unit activity for the year ended December 31, 2018, is as follows (share numbers in thousands):

	NUMBER OF UNITS OUTSTANDING	WEIGHTED AVERAGE GRANT DATE FAIR VALUE
Awarded and unvested, December 31, 2017	2,293	$ 44.64
Granted	810	75.34
Vested	(937)	44.62
Forfeited	(225)	49.37
AWARDED AND UNVESTED AS OF DECEMBER 31, 2018	**1,941**	**$56.91**
RSUs EXPECTED TO VEST AS OF DECEMBER 31, 2018	**1,693**	

Included in the RSU grants for the year ended December 31, 2018 are approximately 71,000 PBRSUs that have both performance criteria tied to the Company's 2020 financial performance and a three-year service criteria.

During the years ended December 31, 2018, 2017, and 2016, the fair value of awards vested were $41.8 million, $41.9 million, and $56.7 million respectively.

At December 31, 2018, the Company had $76.1 million of total unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options, RSUs and PBRSUs that will be recognized over a weighted-average period of approximately two years.

Tax Benefit Included in the Provision for Income Taxes

The total tax benefit included in the provision for income taxes in connection with stock-based compensation for the years ended December 31, 2018, 2017 and 2016 was $18.2 million, $17.8 million and $17.2 million, respectively.

Note 11—Income Taxes

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

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
United States	$ 59,562	$ 35,213	$ 26,440
Foreign	96	32	148
TOTAL	**$59,658**	**$35,245**	**$26,588**

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

	DECEMBER 31,		
	2018	2017	2016
FEDERAL:			
Current	$ (90)	$ 912	$ 837
Deferred	6,199	(2,884)	7,306
	6,109	(1,972)	8,143
STATE:			
Current	3,274	3,937	188
Deferred	(277)	3,050	1,895
	2,997	6,987	2,083
FOREIGN:			
Current	448	472	758
Deferred	(292)	(327)	(302)
	156	145	456
TOTAL INCOME TAX EXPENSE (BENEFIT):			
Current	3,632	5,321	1,783
Deferred	5,630	(161)	8,899
	$9,262	**$5,160**	**$10,682**

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

	DECEMBER 31,		
	2018	2017	2016
Income tax expense at statutory rate	21.0%	35.0%	35.0%
State income taxes	0.2	0.8	(2.8)
Stock-based compensation	(10.2)	(3.2)	(0.4)
R&D tax credit	(3.7)	(4.3)	(6.6)
Non-deductible executive compensation	3.5	5.4	4.7
Valuation allowance	3.1	6.4	7.4
Uncertain tax benefit liability settlement	—	—	1.4
Tax reform	—	(25.2)	—
Other	1.6	(0.3)	1.5
	15.5%	**14.6%**	**40.2%**

On December 22, 2017, the U.S. government enacted the Tax Act. The Tax Act introduces tax reform that reduces the current corporate federal income tax rate from 35% to 21%, among other changes. The rate reduction was effective January 1, 2018.

Following the enactment of the Act, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 ("SAB 118"), which provided guidance on accounting for the tax effects of the Tax Act. SAB 118 provided a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740, *Income Taxes* ("ASC 740"). At December 31, 2017, in accordance with SAB 118, the Company reflected the income tax effects of those aspects of the Act for which the accounting under ASC 740 was complete and recorded a reasonable provisional estimate for certain income tax effects of the Tax Act and recorded an $8.9 million non-cash benefit due to the revaluation of its federal tax liabilities, as a result of the reduction in the U.S. federal statutory tax rate. At December 31, 2018, the Company completed the measurement period under SAB 118 and finalized its provision for certain income tax effects of the Tax Act, noting no material changes to the amounts previously recorded at the end of 2017.

On April 2, 2018, Shutterfly acquired the stock of Lifetouch, a U.S. company incorporated in Minnesota, for approximately $825.0 million. The acquisition was structured as a stock acquisition with an Internal Revenue Code Section 338 (h) (10) election, which resulted in the acquisition being treated as an acquisition of assets for income tax purposes. All amounts disclosed below include the effects of the Lifetouch combination unless stated otherwise.

At December 31, 2018 the Company had approximately $3.0 million, $11.4 million and $3.1 million of federal, California and Canada net operating loss carryforwards, respectively. These carryforwards will expire beginning in the year 2028, 2031 and 2037 for Federal, California and Canada purposes, respectively.

The Company also had research and development credit carryforwards of approximately $15.0 million and $18.2 million for federal and state income tax purposes, respectively, at December 31, 2018. The research and development credits may be carried forward over a period of 20 years for federal tax purposes, indefinitely for California tax purposes, and 15 years for Arizona purposes. The research and development tax credit will begin to expire starting in 2029 for federal and 2023 for Arizona.

The Internal Revenue Service ("IRS") limits the use of net operating loss and tax credit carryforwards in the case of an "ownership change" of a corporation. Any ownership changes, as defined, may restrict utilization of carryforwards.

The components of the net deferred tax assets as of December 31, 2018 and 2017 are as follows (in thousands):

	DECEMBER 31,	
	2018	2017
DEFERRED TAX ASSETS:		
Net operating loss carryforwards	$ 2,248	$ 1,837
Reserves and other tax benefits	37,950	33,145
Tax credits	36,248	32,057
DEFERRED TAX ASSETS	**76,446**	**67,039**
Valuation allowance	(18,936)	(17,111)
NET DEFERRED TAX ASSETS	**57,510**	**49,928**
DEFERRED TAX LIABILITIES:		
Depreciation and amortization	(59,839)	(47,293)
NET DEFERRED TAX ASSETS (LIABILITIES)	**$ (2,329)**	**$ 2,635**

Realization of deferred tax assets is dependent upon the generation of future taxable income, if any, the timing and amount of which are uncertain. The valuation allowance related to deferred income taxes was $18.9 million and $17.1 million as of December 31, 2018 and December 31, 2017, respectively. The increase in the valuation allowance was attributed to the Company's generation of certain California and other state income tax credits which it believes it will not be able to utilize.

Based on the Company's assessment, excluding the valuation allowance recorded related to certain state deferred tax assets that are not likely to be realized, it is more likely than not that the Company's U.S. net deferred tax asset will be realized through future taxable earnings, and/or the reversal of existing taxable temporary differences as of December 31, 2018. Shutterfly's business is cyclical and taxable income is highly dependent on revenue that historically has occurred during the fourth quarter. If there are changes to this historic trend and the Company's fourth quarter does not yield results in-line with expectations, the Company may not be profitable in a given year resulting in a potential cumulative loss. When a tax planning strategy is feasible and prudent, the Company would pursue any possible tax planning strategies to avoid the expiration of the Company's tax attributes and none have been identified or considered as of December 31, 2018. Accordingly, with exception of the valuation allowance discussed above, no additional valuation allowance has been recorded on this net asset as of December 31, 2018. The Company will continue to assess the need for a valuation allowance in the future.

As of December 31, 2018, the Company had $10.2 million of unrecognized tax benefits. A reconciliation of the beginning and ending amounts of unrecognized income tax benefits is as follows (in thousands):

	2018	2017	2016
Balance of unrecognized tax benefits at January 1	$ 9,029	$ 6,586	$ 5,703
Additions for tax positions of prior years	160	1,393	—
Additions for tax positions related to current year	1,031	1,050	951
Reductions for tax positions of prior years	—	—	(68)
BALANCE OF UNRECOGNIZED TAX BENEFITS AT DECEMBER 31	**$10,220**	**$9,029**	**$6,586**

If the $10.2 million of unrecognized tax benefits as of December 31, 2018 is recognized, approximately $5.2 million would decrease the effective tax rate in the period in which each of the benefits is recognized. The remaining amount would be offset by the reversal of related deferred tax assets on which a valuation allowance is placed. The Company does not expect any material changes to its unrecognized tax benefits within the next twelve months.

The Company's policy is to recognize interest or penalties related to all tax positions in income tax expense. To the extent that accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision in the period that such determination is made. The amounts accrued for interest and penalties related to tax uncertainties were not significant for the year ended December 31, 2018. No amounts were accrued for the year ended December 31, 2017.

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

As of December 31, 2018, the Company is subject to taxation in the United States, Canada and Israel. The Company is subject to examination for tax years including and after 2015 for federal income taxes. Certain tax years outside the normal statute of limitation remain open to audit by tax authorities due to tax attributes generated in those early years which have been carried forward and may be audited in subsequent years when utilized.

Note 12—Employee Benefit Plan

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

In 2018, the Company made discretionary contributions to the 401(k) plan in the amount of $4.6 million, with no significant discretionary contributions in 2017 and 2016.

Note 13—Share Repurchase Program

On October 24, 2012, the Company's Board of Directors conditionally authorized and the Audit Committee subsequently approved a share repurchase program for up to $60.0 million of the Company's common stock. As of December 31, 2018, the Company's Board of Directors had approved increases to the program on the following dates:

- On February 6, 2014, the Company's Board of Directors approved an increase of $100.0 million in addition to any amounts repurchased as of that date.
- On February 9, 2015, the Company's Board of Directors approved an increase of $300.0 million in addition to any amounts repurchased as of that date.
- On April 21, 2016, the Company's Board of Directors approved an increase of $100.0 million in addition to any amounts repurchased as of that date.
- On April 18, 2017, the Company's Board of Directors approved an increase of $140.0 million in addition to any amounts repurchased as of that date.

The Company suspended its share repurchase program as of December 31, 2017.

The share repurchase program is subject to prevailing market conditions and other considerations, does not require the Company to repurchase any dollar amount or number of shares, and may be suspended or discontinued at any time. The share repurchase authorization, which was effective immediately, permits the Company to effect repurchases for cash from time to time through open market, privately negotiated or other transactions, including pursuant to trading plans established in accordance with Rules 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended, or by a combination of such methods.

The following table provides information about the Company's repurchase of shares of the Company's common stock for fiscal years 2016, 2017, and 2018:

PERIOD(1)	TOTAL NUMBER OF SHARES PURCHASED	AVERAGE PRICE PAID PER SHARE	TOTAL DOLLAR VALUE SPENT ON REPURCHASES (IN THOUSANDS)
2016 Repurchases	2,524,752	$44.55	$112,488
2017 Repurchases	2,325,825	$47.29	$110,000
2018 Repurchases	—	—	—

(1) All shares were purchased pursuant to the publicly announced share repurchase program described above. Shares are reported in a period based on the settlement date of the applicable repurchase. All repurchased shares of common stock have been retired.

Note 14—Debt

2017 Syndicated Credit Facility

On August 17, 2017 ("Closing Date"), the Company entered into a credit agreement ("Credit Agreement") with certain lenders and Morgan Stanley Senior Funding, Inc., as administrative agent and collateral agent. The Credit Agreement provides for (a) a secured revolving loan facility in an aggregate principal amount of up to $200.0 million ("Revolving Loan Facility") and (b) a secured delayed draw term loan facility ("Initial Term Loan") in an aggregate principal amount of up to $300.0 million. The Credit Agreement permits the Company to add one or more incremental term loan facilities and/or increase the commitments for revolving loans subject to certain conditions.

In October 2017, the Company fully drew the $300.0 million Term Loan under the Credit Agreement. On April 2, 2018, the Company entered into an amendment under the Credit Agreement for an incremental term loan in an aggregate principal amount of $825.0 million ("Incremental Term Loan") to finance the acquisition of Lifetouch, Inc. The full amount of the $200.0 million Revolving Loan Facility remains undrawn as of December 31, 2018.

Upon funding of the Term Loan on October 18, 2017, the Company elected to bear interest rate of one-month LIBOR, subject to a floor of 0.0%, plus an applicable margin of 2.50% per annum. Upon funding of the Incremental Term Loan, the Company elected to bear interest at a rate of one-month LIBOR, subject to a floor of 0.0%, plus an applicable margin of 2.75% per annum. The applicable margin of 2.75% for the Incremental Term Loan is determined based on a secured leverage ratio as defined by the Incremental Term Loan Amendment dated April 2, 2018.

The effective interest rate for the unhedged portion of the Initial Term Loan for year ended December 31, 2018 was 4.48%. The effective interest rate for the Incremental Term Loan for the year ended December 31, 2018 was 4.86%.

The revolving loans under the Credit Agreement bear interest, at the election of the Company, at either (a) the base rate (the "Base Rate"), which is defined as a fluctuating rate per annum equal to the greatest of (1) the prime rate then in effect, (2) the federal funds rate then in effect, plus 0.50%, and (3) an adjusted LIBOR rate determined on the basis of a one-month interest period, plus 1.0% or (b) an adjusted LIBOR Rate, subject to a floor of 0.0% (the "LIBOR Rate"), in each case, plus an applicable margin of (1) initially, 0.75% per annum in the case of Base Rate loans and 1.75% per annum in the case of LIBOR Rate loans or (2) following the Company's delivery of financial statements for the first full fiscal quarter following the Closing Date, 0.50% to 0.75% per annum in the case of Base Rate loans and 1.50% to 1.75% per annum in the case of LIBOR Rate loans, in each case based on the Company's consolidated secured net leverage ratio, measured as of the end of the most recently ended fiscal quarter. In connection with the Credit Agreement, the Company is also required to pay commitment fees, closing fees, arrangement fees, ticking fees and administration fees, and other customary fees and costs.

Both the Initial Term Loan and the Incremental Term Loan have a maturity date of August 17, 2024. Commencing on the respective last day of the first full fiscal quarter following the Company's respective borrowing of the Initial Term Loan and the Incremental Term Loan, the respective Initial Term loan and Incremental Term Loan amortize in equal quarterly installments of 0.25% of the outstanding principal balance for each loan, with the remaining respective principal balances payable on the maturity date. Amounts drawn on the Revolving Loan Facility, if any, mature on August 17, 2022. Further, the Company has the right to prepay its borrowings under the Credit Agreement in whole or in part at any time without a premium or penalty, subject to certain limitations. The Credit Agreement also contains certain customary mandatory prepayments under certain conditions as set forth in the Credit Agreement.

The Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company's and its subsidiaries' ability to, among other things, incur indebtedness, grant liens, undergo certain fundamental changes, dispose of assets, make investments, enter into transactions with affiliates, and make certain restricted payments (including declaration and payment of dividends), in each case subject to limitations and exceptions set forth in the Credit Agreement. The Company is also required to maintain compliance, measured as of the end of each fiscal quarter, with a consolidated secured net leverage ratio and a consolidated interest expense coverage ratio. As of December 31, 2018, the Company is in compliance with these financial covenants.

In August 2017, the Company entered into certain interest-rate swap agreements with an effective date of October 18, 2017 that have the economic effect of modifying a portion of the variable interest-rate obligations associated with the Initial Term Loan so that the interest payable on such portion become fixed (refer to *Note 8—Derivative Financial Instruments* for further details regarding the interest-rate swap agreements).

The Company incurred origination costs of $5.6 million during the year ended December 31, 2017 related to the Credit Agreement and $18.3 million during the year ended December 31, 2018 related to the Incremental Term Loan. The origination costs attributable to the Revolving Loan Facility were capitalized within prepaid expenses for the current portion and other assets for the non-current portion. The origination costs attributable to the Initial Term Loan and the Incremental Term Loan are presented as a reduction to the carrying value of the debt in the consolidated balance sheets. Fees attributable to the Revolving Loan Facility of $0.8 million are being amortized over five years as component of interest expense. The fees attributable to the Initial Term Loan of $4.8 million and the Incremental Term Loan of $18.3 million are being amortized over the term of the loans, both as a component of interest expense.

The Initial Term Loan and the Incremental Term Loan consist of the following (in thousands):

	DECEMBER 31, 2018	DECEMBER 31, 2017
Principal borrowings	$ 1,125,000	$ 300,000
Less: principal payments	(7,109)	—
Less: debt issuance costs, net of amortization	(20,044)	(4,543)
NET CARRYING AMOUNT	**$1,097,847**	**$295,457**
Term loans, current	$ 11,137	$ 3,000
TERM LOANS, NON-CURRENT	**$1,086,710**	**$292,457**

The following table sets forth the total interest expense recognized related to the Initial Term Loan and the Incremental Term Loan during the years ended December 31, 2018 and 2017 (in thousands):

	DECEMBER 31, 2018	DECEMBER 31, 2017
Floating interest (including the effects of cash flow hedges)	$ 43,916	$ 2,505
Amortization of debt issuance costs	2,846	247
Delayed draw ticking fees	—	551
	$46,762	**$3,303**

Assumed Notes Payable from the Acquisition of Lifetouch

In connection with the acquisition of Lifetouch in the second quarter of 2018 (refer to Note 4—*Acquisition*), the Company assumed $9.1 million of legacy Lifetouch notes payable (of which $3.8 million was classified as current), which is payable in varying principal payments plus interest rates ranging from 0.0% to 2.2% with maturities at various dates through July 2022. These notes payable were issued by Lifetouch to finance various acquisitions and represent promissory notes issued to the owners of the acquired companies for an amount equal to the purchase consideration. Payments of principal for these notes payable during the year ended December 31, 2018 was $2.5 million.

As of December 31, 2018, the estimated future principal payments of the Initial Term Loan, Incremental Term Loan and the assumed Lifetouch notes payable are as follows (in thousands):

YEAR ENDING DECEMBER 31,	
2019	$ 14,390
2020	13,037
2021	12,052
2022	11,545
2023	10,700
Thereafter	1,063,304
	$1,125,028

0.25% Convertible Senior Notes Due and Paid May 15, 2018

In May 2013, the Company issued $300.0 million aggregate principal amount of 0.25% convertible senior notes (the "Notes") which were due and paid on May 15, 2018. Interest was payable semiannually in arrears on May 15 and November 15 of each year, commencing on November 15, 2013. Upon maturity, the Company paid the aggregate principal amount of $300.0 million and delivered 1,108,000 shares of the Company's common stock. The Company also received 1,108,000 shares of the Company's common stock from a note hedge transaction that was entered into in May 2013 to minimize the potential economic dilution upon the aforementioned conversion of the Notes.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the

liability component from the face value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount (“debt discount”) is amortized to interest expense over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the Note issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Issuance costs attributable to the liability component, totaling $6.4 million, were amortized to expense over the term of the Notes, and issuance costs attributable to the equity component, totaling $1.7 million, were netted with the equity component in stockholders’ equity.

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

The Notes were paid in May 2018. As of December 31, 2017, Notes consist of the following (in thousands):

	DECEMBER 31, 2017
LIABILITY COMPONENT:	
Principal	$ 300,000
Less: debt issuance costs, debt discount, net of amortization	(5,946)
NET CARRYING AMOUNT (CLASSIFIED AS CURRENT)	**$294,054**
EQUITY COMPONENT(1)	**$ 63,510**

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

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

	YEAR ENDED DECEMBER 31,		
	2018	2017	2016
0.25% coupon	$ 281	$ 750	$ 750
Amortization of debt issuance costs	543	1,395	1,319
Amortization of debt discount	5,403	13,866	13,113
	$6,227	**$16,011**	**$15,182**

Note Hedge

To minimize the impact of potential economic dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock (the “Note Hedge”). In May 2013, the Company paid an aggregate amount of $63.5 million for the Note Hedge. The Note Hedge expired upon maturity of the Notes in May 2018. The Note Hedge was intended to offset the potential dilution upon conversion of the Notes and/or offset any cash payments the Company is required to make in excess of the principal amount upon conversion of the Notes in the event that the market value per share of the Company’s common stock, as measured under the Notes, is greater than the strike price of the Note Hedge, which initially corresponds to the conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the Notes. Upon expiration of the Note Hedge in May 2018, the Company received 1,108,000 shares of the Company’s common stock from the Note Hedge counterparties.

Warrant

Separately, in May 2013, the Company entered into warrant transactions (the "Warrant"), whereby the Company sold warrants to acquire shares of the Company's common stock at a strike price of $83.18 per share. The Company received aggregate proceeds of $43.6 million from the sale of the Warrant. Commencing on August 15, 2018, the Company was required to begin settlement of the warrants ratably over an 80-trading-day period. Based on the Company's stock price from August 15, 2018 through December 6, 2018, no shares were required to be settled during this period.

Note 15—Segment Reporting

The Company reports segment information based on its internal reporting used by management for making decisions and assessing performance as the source of its reportable segments. As a result of the acquisition of Lifetouch in the second quarter of 2018, the Company entered into a new business and as a result, the Company has a new reportable and operating segment described further below.

The Chief Operating Decision Maker ("CODM") function uses segment margin to evaluate the performance of the segments and allocate resources. Management considers segment margin to be the appropriate metric to evaluate and compare the ongoing performance of each reportable segment as it is the level at which direct costs associated with the performance of the segment are monitored.

During the second quarter of 2018, the Company expanded its segment reporting. As a result, the profitability metric by which the Company's CODM measures segment performance and allocates resources changed from segment gross profit to segment margin. Segment margin includes technology and development expenses, sales and marketing expenses, and credit card fees, arriving at a margin for the segment. Segment margin excludes corporate expenses, amortization of intangible assets, stock-based compensation expense, and other non-recurring items including restructuring charges and acquisition-related costs. Corporate expenses include activities that are not directly attributable or allocable to a specific segment.

The Company's segments are determined based on the products and services each segment provides and how the CODM evaluates the business. The Company has the following reportable segments:

> Shutterfly Consumer - Includes sales from the Company's brands and are derived from the sale of a variety of products such as, cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and prints, and related shipping revenue, as well as rental revenue from its BorrowLenses brand. Revenue from advertising displayed on the Company's website is also included in Shutterfly Consumer revenue.
>
> Lifetouch - Includes revenue from professional photography services for schools, preschools and retail studios operated by Lifetouch under the JCPenney Portrait brand as well as churches and other groups.
>
> Shutterfly Business Solutions - Includes revenue from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for the Company's business customers.

Segment assets are not reported to, or used by, the CODM to allocate resources or assess performance of the Company's segments. Accordingly, the Company has not disclosed asset information by segment. Substantially all of the Company's revenue is generated from sales originating in the United States.

The Company's segment results for fiscal 2018, 2017 and 2016 were as follows (dollars in thousands):

	YEAR ENDED DECEMBER 31		
	2018	2017	2016
SHUTTERFLY CONSUMER:			
Net revenue	$ 971,829	$ 996,963	$ 997,556
Cost of net revenue	452,226	456,665	455,387
Technology and development	124,670	140,698	146,216
Sales and marketing	168,442	170,687	198,583
Credit card fees	25,072	25,645	26,319
MARGIN(1)	**$ 201,419**	**$ 203,268**	**$ 171,051**
Margin %	20.7%	20.4%	17.1%
LIFETOUCH(2):			
Net revenue(3)	$ 798,718	$ —	$ —
Cost of net revenue(4)	299,467	—	—
Technology and development	21,711	—	—
Sales and marketing(5)	288,578	—	—
Credit card fees	8,951	—	—
MARGIN(1)	**$ 180,011**	**$ —**	**$ —**
Margin%	22.5%	—%	—%
SHUTTERFLY BUSINESS SOLUTIONS:			
Net revenue	$ 230,588	$ 193,239	$ 136,668
Cost of net revenue	187,392	154,068	100,582
Technology and development	13,614	17,907	12,142
Sales and marketing	6,067	4,476	5,005
MARGIN(1)	**$ 23,515**	**$ 16,788**	**$ 18,939**
Margin %	10.2%	8.7%	13.9%
CONSOLIDATED SEGMENTS:			
Net revenue(3)	$2,001,135	$1,190,202	$1,134,224
Cost of net revenue(4)	939,085	610,733	555,969
Technology and development	159,995	158,605	158,358
Sales and marketing	463,087	175,163	203,588
Credit card fees	34,023	25,645	26,319
MARGIN(1)	**$ 404,945**	**$ 220,056**	**$ 189,990**
Margin %	20.2%	18.5%	16.8%

(1) The margins reported reflect only costs that are directly attributable or allocable to a specific segment and exclude corporate expenses, amortization of intangible assets, stock-based compensation expense and other one-time charges.

(2) The Company acquired Lifetouch on April 2, 2018.

(3) Yearbook sales and collections for the Lifetouch segment are made throughout the school year, whereas yearbooks are typically delivered toward the end of the school year in the second quarter of the fiscal year. Business combination accounting principles require the Company to record the assumed deferred revenue at fair value on the acquisition date measured based on the cost to manufacture and deliver the yearbooks, plus a profit margin. Segment reporting includes this purchase accounting adjustment which primarily relates to yearbook sales in net revenue for the Lifetouch segment.

(4) Business combination accounting principles require the Company to measure acquired inventory at fair value. The fair value of inventory reflects Lifetouch's cost of manufacturing plus a portion of the expected profit margin. Segment reporting excludes this purchase accounting adjustment from cost of net revenue for the Lifetouch segment.

The following table reconciles segment margin to total operating income and income before income taxes, segment net revenue to Net revenue, and segment cost of net revenue to Cost of net revenue for the years ended December 31, 2018, 2017 and 2016 (in thousands):

	YEAR ENDED DECEMBER 31		
	2018	2017	2016
Total segment margin	$ 404,945	$ 220,056	$ 189,990
Purchase accounting deferred revenue adjustment(1)	(39,315)	—	—
Purchase accounting inventory adjustment(2)	(10,931)	—	—
Purchase accounting deferred rent adjustment(3)	(292)	—	—
Corporate expenses(4)	(130,642)	(74,903)	(75,068)
Amortization of intangible assets	(40,424)	(14,916)	(20,120)
Stock-based compensation expense	(47,721)	(43,573)	(45,692)
Restructuring	(4,618)	(16,966)	—
Acquisition-related costs	(15,549)	—	—
Capital lease termination	—	(8,098)	—
INCOME FROM OPERATIONS	**$ 115,453**	**$ 61,600**	**$ 49,110**
Income from operations	$ 115,453	$ 61,600	$ 49,110
Interest expense	(61,239)	(27,836)	(23,023)
Interest and other income, net	5,444	1,481	501
INCOME BEFORE INCOME TAXES	**$ 59,658**	**$ 35,245**	**$ 26,588**
Total segment net revenue	$ 2,001,135	$ 1,190,202	$ 1,134,224
Purchase accounting deferred revenue adjustment(1)	(39,315)	—	—
NET REVENUE	**$1,961,820**	**$1,190,202**	**$1,134,224**
Total segment cost of net revenue	$ 939,085	$ 610,733	$ 555,969
Purchase accounting inventory adjustment(2)	10,931	—	—
Stock-based compensation expense for cost of net revenue	3,824	4,339	4,579
Amortization of intangible assets for cost of net revenue	7,735	4,578	5,569
COST OF NET REVENUE	**$ 961,575**	**$ 619,650**	**$ 566,117**

(1) Yearbook sales and collections for the Lifetouch segment are made throughout the school year, whereas yearbooks are typically delivered toward the end of the school year in the second quarter of the fiscal year. Business combination accounting principles require the Company to record the assumed deferred revenue at fair value on the acquisition date measured based on the cost to manufacture and deliver the yearbooks, plus a profit margin. Segment reporting includes this purchase accounting adjustment which primarily relates to yearbook sales in net revenue for the Lifetouch segment.

(2) Business combination accounting principles require the Company to measure acquired inventory at fair value. The fair value of inventory reflects the acquired company's cost of manufacturing plus a portion of the expected profit margin. Management reporting excludes this purchase accounting adjustment from cost of net revenue for the Lifetouch segment.

(3) Segment reporting excludes this purchase accounting adjustment for deferred rent.

(4) Corporate expenses include activities that are not directly attributable or allocable to a specific segment. This category consists primarily of expenses related to certain functions performed at the corporate level such as non-manufacturing facilities, human resources, finance and accounting, legal, information technology, integration, etc.

Note 16—Restructuring

2018 Restructuring Plan

During the fourth quarter of 2018, the Company's Board of Directors approved a restructuring plan to close four Lifetouch facilities in 2019 ("2018 Restructuring Plan"): Loves Park, Illinois; Bloomington, Minnesota; Chico, California; and Chattanooga, Tennessee and consolidate this volume into existing Shutterfly facilities and a new 237,000 square foot facility in Texas to be completed in the first half of 2020. The consolidation involves a mix of moving existing Lifetouch equipment to Shutterfly facilities, and migrating Lifetouch volumes to Shutterfly's digital presses. Given the adjacent peak periods of the Shutterfly Consumer and the Lifetouch businesses, this consolidation of facilities will further reduce the Company's reliance on temporary labor while improving the utilization of existing assets.

The Company plans to retain a portion of the impacted employees in this transaction, who will move to other existing Shutterfly or Lifetouch facilities, and the Company will offer appropriate severance and/or retention packages to other employees. During the fourth quarter of 2018, the planned exit resulted in restructuring charges of $1.7 million and consisted of employee related costs of $0.9 million and depreciation of property and equipment of $0.8 million. The Company expects to complete the 2018 Restructuring Plan by the end of 2019 and is currently in the process of estimating the financial impact on its financial statements.

iMemories Restructuring

The Company completed the acquisition of Lifetouch on April 2, 2018. At the time the Company purchased Lifetouch, it anticipated that it would exit the iMemories business, as Shutterfly Photos was a more complete and advanced solution ("iMemories Restructuring"). The Company decided to accelerate the process of exiting iMemories, which was completed in the second quarter of 2018 and was divested for a nominal amount. The exit resulted in restructuring charges of $3.0 million consisted of lease termination costs of $1.0 million, employee-related costs of $0.8 million and other costs of $1.2 million. Payments of $2.2 million in connection with these charges were made during the second quarter of 2018. The remaining $0.8 relates to non-cash restructuring charges primarily related to write-off of certain assets. The Company does not expect to incur any further charges in connection with this divestiture.

2017 Restructuring Plan

During the first quarter of 2017, the Board of Directors approved, committed to and initiated a plan to significantly simplify the Consumer business during 2017 ("2017 Restructuring Plan"). As of December 31, 2018, the Company had substantially completed all actions under the 2017 Restructuring Plan. The Tiny Prints, MyPublisher and Wedding Paper Divas legacy websites were shut down. To retain as many customers and as much revenue as possible, the Company sought to migrate customers from the legacy websites to Shutterfly.com. Further, as part of the plan, the Company announced that it would undertake a strategic review of BorrowLenses for possible sale. The Company completed the strategic review process in the third quarter of 2017 and decided to retain and operate the business. Total restructuring costs associated with the 2017 Restructuring Plan were $16.8 million and impacted the restructuring expense line items within cost of net revenue and operating expenses in the consolidated statement of operations during the year ended December 31, 2017.

Restructuring Activity

The following table summarizes the restructuring costs recognized during the years ended December 31, 2018, 2017, and 2016 (in thousands):

FISCAL 2018 ACTIVITY	BALANCE DECEMBER 31, 2017(1)	RESTRUCTURING CHARGES	CASH PAYMENTS	NON-CASH ADJUSTMENTS(2)	BALANCE DECEMBER 31, 2018(1)
2018 RESTRUCTURING PLAN:					
Employee costs	$ —	$ 861	$ —	$ —	$ 861
Property and equipment	—	805	—	(805)	—
TOTAL 2018 RESTRUCTURING PLAN	**$ —**	**$1,666**	**$ —**	**$ (805)**	**$ 861**
IMEMORIES RESTRUCTURING	**$ —**	**$2,952**	**$(2,200)**	**$ (752)**	**$ —**
2017 RESTRUCTURING PLAN	**$1,846**	**$ —**	**$(1,238)**	**$ (486)**	**$ 122**
2015 RESTRUCTURING PLAN	**$1,393**	**$ —**	**$ (244)**	**$ —**	**$1,149**
TOTAL RESTRUCTURING PLANS	**$3,239**	**$4,618**	**$(3,682)**	**$(2,043)**	**$2,132**

FISCAL 2017 ACTIVITY	BALANCE DECEMBER 31, 2016(1)	RESTRUCTURING CHARGES	CASH PAYMENTS	NON-CASH ADJUSTMENTS(2)	BALANCE DECEMBER 31, 2017(1)
2017 RESTRUCTURING PLAN:					
Property and equipment	$ —	$ 8,233	$ (250)	$ (6,933)	$ 1,050
Employee costs	—	5,851	(4,658)	(814)	379
Inventory	—	1,475	—	(1,475)	—
Other costs	—	1,226	(786)	(23)	417
TOTAL 2017 RESTRUCTURING PLAN	**$ —**	**$16,785**	**$(5,694)**	**$(9,245)**	**$1,846**
2015 RESTRUCTURING PLAN	**$1,602**	**$ 181**	**$ (390)**	**$ —**	**$1,393**
TOTAL RESTRUCTURING PLANS	**$1,602**	**$16,966**	**$(6,084)**	**$(9,245)**	**$3,239**

FISCAL 2016 ACTIVITY	BALANCE DECEMBER 31, 2015(1)	RESTRUCTURING CHARGES	CASH PAYMENTS	BALANCE DECEMBER 31, 2016(1)
2015 RESTRUCTURING PLAN:				
Employee costs	$ 466	$ 61	$ (527)	$ —
Other costs	2,059	229	(686)	1,602
TOTAL RESTRUCTURING PLAN	**$2,525**	**$290**	**$(1,213)**	**$1,602**

(1) Restructuring costs as of December 31, 2018, 2017 and 2016 are recorded in accrued liabilities and other non-current liabilities.

(2) Non-cash adjustments include depreciation and amortization of property and equipment (primarily capitalized software development costs and manufacturing equipment) and intangible assets, inventory markdowns, stock-based compensation, and other non-cash costs incurred as part of the restructuring.

Note 17—Quarterly Financial Data (Unaudited)

The Company acquired Lifetouch on April 2, 2018. Results of Lifetouch are included in the consolidated statement of operations from the date of its acquisition in the second quarter of 2018. Due to the seasonal nature of the Company's business, fourth quarter operating results typically represent a substantially larger share of total year revenue and earnings because they include the holiday season and the traditional fall school picture season. The Company follows the same accounting policies for preparing its quarterly and annual financial data that is summarized for the years ended December 31, 2018 and 2017 as follows (in thousands, except per share amounts):

	YEAR ENDED DECEMBER 31, 2018			
	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
Net revenue	$199,725	$443,372	$368,757	$949,966
Gross profit	$ 73,679	$210,144	$144,019	$572,404
Net income (loss)	$ (27,165)	$ (26,512)	$ (73,543)	$177,616
Net income (loss) per common share:				
Basic	$ (0.83)	$ (0.80)	$ (2.20)	$ 5.28
Diluted	$ (0.83)	$ (0.80)	$ (2.20)	$ 5.19

	YEAR ENDED DECEMBER 31, 2017			
	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
Net revenue	$191,972	$209,032	$195,443	$593,755
Gross profit	$ 74,613	$ 90,631	$ 64,296	$339,537
Net income (loss)	$ (33,194)	$ (22,838)	$ (25,607)	$111,724
Net income (loss) per common share:				
Basic	$ (0.98)	$ (0.68)	$ (0.78)	$ 3.45
Diluted	$ (0.98)	$ (0.68)	$ (0.78)	$ 3.37

Note 18—Subsequent Event

In January 2019, the Company repaid $200.0 million of the Incremental Term Loan that was used to finance the acquisition of Lifetouch.

Schedule II
Valuation and Qualifying Accounts

	BALANCE AT BEGINNING OF PERIOD	ADDITIONS		DEDUCTIONS	BALANCE AT END OF PERIOD
		CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS		
			(in thousands)		
ALLOWANCE FOR DOUBTFUL ACCOUNTS					
Year ended December 31, 2016	$ 10	45	—	(20)	$ 35
Year ended December 31, 2017	$ 35	—	—	(35)	$ —
Year ended December 31, 2018	$ —	34	—	(32)	$ 2
TAX VALUATION ALLOWANCE					
Year ended December 31, 2016	$ 8,161	1,956	—	(119)	$ 9,998
Year ended December 31, 2017	$ 9,998	3,773	3,340	—	$17,111
Year ended December 31, 2018	$17,111	2,126	(301)	—	$18,936

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

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2018. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, ("Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this annual report on Form 10-K. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2018, our disclosure controls and procedures were effective at the reasonable assurance level.

Management's Report on Internal Control over Financial Reporting

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

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

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

In accordance with guidance issued by the Securities and Exchange Commission, companies are permitted to exclude acquisitions from their final assessment of internal control over financial reporting for the first fiscal year in which the acquisition occurred. Our evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2018 did not include the internal controls of Lifetouch, Inc. ("Lifetouch") because Lifetouch was acquired in a business combination in April 2018. Lifetouch is a wholly-owned subsidiary of the Company whose total assets represent 10% and total revenue represents 39% of the related consolidated financial statement amounts as of and for the year ended December 31, 2018.

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2018.

We reviewed the results of management's assessment with the Audit Committee of the Board of Directors. The effectiveness of our internal control over financial reporting as of December 31, 2018 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2018 that materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

Limitation on Effectiveness of Controls

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

ITEM 9B. OTHER INFORMATION

None.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

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

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

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

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

The information concerning material changes to the procedures by which stockholders may recommend nominees to the Board of Directors required by this Item, if any, is incorporated by reference to information set forth in the Proxy Statement, in the section entitled "Corporate Governance—Stockholder Nominations to the Board Of Directors."

The information concerning the audit committee of the Board of Directors and the audit committee financial experts required by this Item is incorporated by reference to information set forth in the Proxy Statement, in the section entitled "Corporate Governance—Board Meetings and Committees."

ITEM 11. EXECUTIVE COMPENSATION.

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

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

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

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

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

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

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

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

Part IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE.

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

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

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

3. *Exhibits*. We have filed, or incorporated into this report by reference, the exhibits listed on the Exhibit List on the following page and are incorporated herein.

EXHIBIT LIST

EXHIBIT NUMBER	EXHIBIT DESCRIPTION	INCORPORATED BY REFERENCE				PROVIDED HEREWITH
		FORM	FILE NO.	DATE OF FIRST FILING	EXHIBIT NUMBER	
3.01	Restated Certificate of Incorporation.	S-1	333-135426	June 29, 2006	3.03	
3.02	Restated Bylaws.	10-Q	001-33031	July 31, 2012	3.02	
4.01	Form of common stock certificate.	S-1/A	333-135426	August 18, 2006	4.01	
4.02	Indenture, dated as of May 20, 2013, by and between Shutterfly, Inc. and Wells Fargo Bank, National Association, as trustee.	8-K	001-33031	May 20, 2013	4.01	
10.01	Form of Indemnity Agreement.*	S-1	333-135426	June 29, 2006	10.01	
10.02	2006 Equity Incentive Plan, as amended.*	10-Q	001-33031	November 5, 2013	10.01	
10.03	Forms of stock option agreement, stock option exercise agreement, restricted stock agreement, restricted stock unit agreement, stock appreciation right agreement and stock bonus agreement under the 2006 Equity Incentive Plan, as amended.*	10-K	001-33031	February 7, 2011	10.24	
10.04	Form of Inducement Restricted Stock Unit Award Agreement.*	10-K	001-33031	February 14, 2013	10.04	
10.05	2015 Equity Incentive Plan.*	DEF 14A	001-33031	November 18, 2015	Appendix A	
10.06	Forms of restricted stock unit agreements, stock appreciation right agreement and stock bonus agreement under the 2015 Equity Incentive Plan.*	S-8	001-33031	December 30, 2015	99.1	
10.07	Offer letter dated January 17, 2007 for Dwayne Black.*	10-K	001-33031	March 20, 2007	10.15	
10.08	Amendment to Offer Letter dated December 23, 2008 for Dwayne Black.*	10-K	001-33031	February 24, 2009	10.20	
10.09	Offer Letter dated October 9, 2014 for Satish Menon.*	10-K	001-33031	February 18, 2015	10.18	
10.10	Offer Letter dated October 23. 2015, by and between Shutterfly, Inc. and Mike Pope.*	8-K	001-33031	October 27, 2015	10.1	
10.11	Offer Letter dated March 15, 2016, by and between Shutterfly, Inc. and Christopher North.*	8-K	001-33031	March 17, 2016	99.1	
10.12	Inducement Stock Option Award, including Notice of Grant, dated March 15, 2016, by and between Shutterfly, Inc. and Christopher North.*	10-Q	001-33031	August 4, 2016	10.03	
10.13	Inducement Restricted Stock Unit Award, including Notice of Grant, dated March 15, 2016, by and between Shutterfly, Inc. and Christopher North.*	10-Q	001-33031	August 4, 2016	10.04	
10.14	Amended and Restated Credit Agreement, dated June 10, 2016, by and among the Company, the Lenders (as defined therein) and JPMorgan Chase Bank, N.A.**	10-Q	001-33031	August 4, 2016	10.05	

EXHIBIT NUMBER	EXHIBIT DESCRIPTION	INCORPORATED BY REFERENCE				PROVIDED HEREWITH
		FORM	FILE NO.	DATE OF FIRST FILING	EXHIBIT NUMBER	
10.15	Form of Amended and Restated Retention Agreement.*	8-K	001-33031	February 17, 2017	99.1	
10.16	Credit Agreement, dated as of August 17, 2017, by and among Shutterfly, Inc., the lenders from time to time party thereto, and Morgan Stanley Senior Funding, Inc., as administrative agent and collateral agent.	8-K	001-33031	October 17, 2017	99.1	
10.17	Stock Purchase Agreement dated January 30, 2018 by and between Shutterfly, Inc., Lifetouch Inc. and Lifetouch Inc. Employee Stock Ownership Trust.	8-K	001-33031	January 30, 2018	2.1	
10.18	Debt Commitment Letter dated January 30, 2018 by and between Shutterfly, Inc.	8-K	001-33031	January 30, 2018	99.1	
10.19	Incremental Term Loan Amendment, dated as of April 2, 2018, to the Credit Agreement, dated as of August 17, 2017, by and among Shutterfly, Inc., the lenders from time to time party thereto, and Morgan Stanley Senior Funding, Inc., as administrative agent and collateral agent.	8-K	001-33031	April 2, 2018	99.1	
10.20	Performance-Based Restricted Stock Unit Award for Christopher North.*	10-Q	001-33031	November 7, 2018	10.01	
10.21	Performance-Based Restricted Stock Unit Award for Michael Meek.*	10-Q	001-33031	November 7, 2018	10.02	
10.22	Offer Letter dated January 19, 2018 for Michael Meek.*					X
10.23	Offer Letter dated May 14, 2018 for Mickey Mericle.*					X
10.24	Shutterfly, Inc. Bonus Plan.*					X
21.01	Subsidiaries of Registrant					X
23.01	Consent of Independent Registered Public Accounting Firm.					X
24.01	Power of Attorney. (See signature page of this Form 10-K).					X
31.01	Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
31.02	Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
32.01	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).***					X
32.02	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).***					X
101	The following financial statements from Shutterfly Inc.'s Annual Report on Form 10-K for the year ended December 31, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Stockholders' Equity, (iv) Consolidated Statements of Comprehensive Income/(Loss), (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements, tagged at Level I through IV.					X

* Represents a management contract or compensatory plan.

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

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

ITEM 16. FORM 10K SUMMARY.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHUTTERFLY, INC.
(Registrant)

Dated: February 28, 2019

By: /s/ Michael Pope

Michael Pope
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

POWER OF ATTORNEY

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

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

SIGNATURE	TITLE	DATE
/s/ Christopher North Christopher North	President, Chief Executive Officer and Director *(Principal Executive Officer)*	February 28, 2019
/s/ Michael Pope Michael Pope	Senior Vice President and Chief Financial Officer *(Principal Financial Officer)*	February 28, 2019
/s/ Lisa Blackwood-Kapral Lisa Blackwood-Kapral	Vice President and Chief Accounting Officer *(Principal Accounting Officer)*	February 28, 2019
/s/ William Lansing William Lansing	Chairman of the Board of Directors and Director	February 28, 2019

SIGNATURE	TITLE	DATE
/s/ Thomas D. Hughes Thomas D. Hughes	Director	February 28, 2019
/s/ Eva Manolis Eva Manolis	Director	February 28, 2019
/s/ Ann Mather Ann Mather	Director	February 28, 2019
/s/ Elizabeth Rafael Elizabeth Rafael	Director	February 28, 2019
/s/ Elizabeth Sartain Elizabeth Sartain	Director	February 28, 2019
/s/ H. Tayloe Stansbury H. Tayloe Stansbury	Director	February 28, 2019
/s/ Brian T. Swette Brian T. Swette	Director	February 28, 2019
/s/ Michael P. Zeisser Michael P. Zeisser	Director	February 28, 2019

Exhibit 23.01

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-173987) and S-8 (No. 333-226737, No. 333-218438, No. 333-211706, No. 333-208793, No. 333-207616, No. 333-202142, No. 333-193941, No. 333-186675, No. 333-178986, No. 333-173939, No. 333-171632, No. 333-164268, No. 333-156659, No. 333-148487, No. 333-137676) of Shutterfly, Inc. of our report dated February 28, 2019 relating to the financial statements, financial statement schedule and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP
San Jose, California February 28, 2019

Exhibit 31.01

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO RULE 13a-14(a) or 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Christopher North, certify that:

1. I have reviewed this annual report on Form 10-K of Shutterfly, 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 and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 28, 2019

By: /s/ Christopher North

Christopher North

President and Chief Executive Officer

Exhibit 31.02

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13a-14(a) or 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Michael Pope, certify that:

1. I have reviewed this annual report on Form 10-K of Shutterfly, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 28, 2019

By: /s/ Michael Pope

Michael Pope

Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.01

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

The undersigned, Christopher North, the President and Chief Executive Officer of Shutterfly, Inc. (the “Company”), pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certifies that:

(i) the Annual Report on Form 10-K for the period ended December 31, 2018 of the Company (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

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

Date: February 28, 2019

By: /s/ Christopher North

Christopher North

President and Chief Executive Officer

Exhibit 32.02

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

The undersigned, Michael Pope, Senior Vice President and Chief Financial Officer of Shutterfly, Inc. (the “Company”), pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certifies that:

(i) the Annual Report on Form 10-K for the period ended December 31, 2018 of the Company (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

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

Date: February 28, 2019

By: /s/ Michael Pope

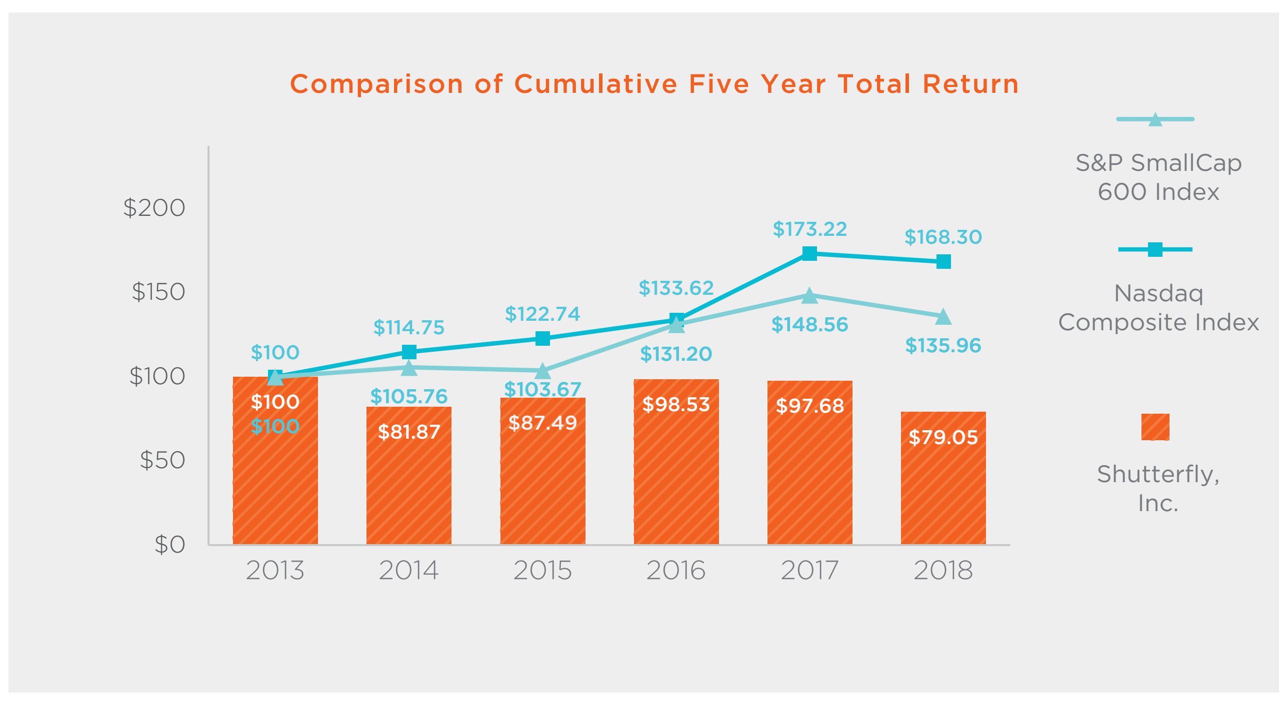
Michael Pope
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

STOCK PERFORMANCE GRAPH

This performance graph shall not be deemed "filed" for purposes of section 18 of the Securities and Exchange Act of 1934, as amended, or otherwise subject to the liabilities under that section and shall not be deemed to be incorporated by reference into any filing of Shutterfly under the Securities Act of 1933, as amended or the Securities and Exchange Act of 1934, as amended.

The following graph compares the total stockholder return on our common stock for the period from December 31, 2013 through December 31, 2018 with that of the NASDAQ Composite Index and the S&P SmallCap 600 Index.

The total return calculations set forth below assume $100 invested on December 31, 2013 with reinvestment of dividends into additional shares of the same class of securities. The stock performance graph below should not be considered indicative of potential future stock price performance.



Shutterfly Inc., 2800 Bridge Parkway, Redwood City, CA 94065 | shutterflyinc.com