# SHUTTERFLY INC

2018 PROXY STATEMENT
AND 2017 ANNUAL REPORT

# LETTER FROM THE CEO

SHUTTERFLY INC

April 13, 2018

DEAR STOCKHOLDERS,

2017 was a pivotal year for Shutterfly. We're proud of the results we delivered and the progress we made on a number of fronts, setting the company up well for 2018 and beyond.

Back in February of 2017, we shared our plans to restructure our Consumer business, consolidating and simplifying our brand portfolio, bringing the vast majority of our customers together on a single website, Shutterfly.com, and focusing our resources on our greatest opportunities. At the same time, we articulated four areas of strategic focus going forward: simplifying the process of creating and purchasing personalized products, expanding our range of products, pivoting to mobile, and leveraging our manufacturing platform to serve business customers.

I'm pleased to report that we succeeded against all of our major objectives for 2017. Even while shutting down brands and consolidating platforms, we retained the majority of revenue and customers from the migrating brands and shuttered websites. The core Shutterfly brand achieved healthy like-for-like growth of 6%, and we held overall Consumer revenue flat while reducing our marketing expenditure by 15% and eliminating around 250 positions. In our Enterprise segment, SBS revenues grew 41% year-over-year as we onboarded a major new program from a large technology client.

At Shutterfly, we believe that the surest path to long-term, profitable growth is through customer-facing innovation; that is, by continually improving and expanding our products and services. The evolution of our mobile app is a great example. Over the course of 2017, we shipped dozens of new app builds; added more than 40 new products, now covering every category; and created an elegantly simple product creation experience. As a result, app revenues more than doubled year-over-year in the fourth quarter and mobile is now an important contributor to our Consumer business.

Throughout this period of transition, we've continued to focus on financial discipline and cost control. We significantly improved profitability and quality of earnings in 2017. At the same time, we entered into a new credit facility with low-cost flexible debt, and returned $110 million to stockholders via share repurchases, following our capital allocation strategy.

Turning to 2018, we couldn't be more excited about our transformational acquisition of Lifetouch, the leader in school photography. This acquisition brings together two uniquely complementary companies, gives Shutterfly access to more than 10 million highly desirable households, positioning Shutterfly to increase revenue and profitability.

Shutterfly and Lifetouch's businesses are both built around helping consumers capture, preserve, and share images linked to important moments in their lives. This deep-seated and enduring human need is reflected in the large and stable demand for our products and services over many years to date and, we predict, for many years to come.

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

As a combined company, we're able to serve our customers across all of the key milestones in the life of a family, helping them commemorate important moments starting at birth, and then throughout the school years from pre-school to graduation, and on to marriage and family holidays. And our combined scale will allow us to better serve our customers and to drive better financial results for investors, through our shared manufacturing platform and large customer base.

Even as we work to integrate Lifetouch into the Shutterfly family, we expect to make significant progress against our four areas of strategic focus. We'll further simplify the creation and purchase of personalized products, improving targeting and personalization across the entire customer journey. We've announced two new categories, Kids and Pets, launching in Q3. We have ambitious plans for mobile, including adding more products and driving improved monetization. And in Enterprise, we'll focus on gross margin improvements as we move into the second phase of the large deal signed in Q3 last year while expanding our sales pipeline and opening our manufacturing platform to a broader range of customer use-cases.

I want to share a few thoughts about where we are on our journey as a company. As of the end of 2017, we've completed the first phase of our transformation during which we simplified the Consumer business; articulated four areas of strategic focus; put in place the operational, process, and financial discipline to support our business as we scale; and delivered significant financial improvements.

As we enter the second phase between 2018 and 2020, we have three clear priorities:

1. Successfully integrate Lifetouch while realizing significant cost and revenue synergies.
2. Re-accelerate Shutterfly's Consumer growth via simplification, range expansion, and mobile.
3. Leverage our world-class digital manufacturing platform to capitalize on the secular shift from analog to digital manufacturing, serving a broader range of enterprise customers.

Looking further ahead, as we repay our acquisition debt, we'll be in a powerful position to create further stockholder value by optimizing capital allocation across organic re-investment in the business, further M&A, and returning excess capital to stockholder. We expect to have compelling organic and inorganic opportunities, and will continue to be disciplined in considering these competing uses of capital.

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

Sincerely,

**CHRISTOPHER NORTH**
President and Chief Executive Officer

# WHO WE ARE

## CONSUMER

**Shutterfly**

The leading digital retailer and manufacturer of high-quality personalized products and services.

**tinyprints**

The leading online cards and stationery boutique, offering stylish announcements, invitations and personal stationery for every occasion.

**Lifetouch**

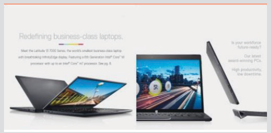
Built on the tradition of "Picture Day," Lifetouch captures smiling faces, preschool through high school graduation. Product lines include sports, events, seniors and yearbooks. Lifetouch also has a Specialty business which includes retail and church photography.

**BORROWLENSES**

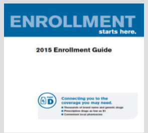
The premier online marketplace for photographic and video equipment rentals.

## SHUTTERFLY BUSINESS SOLUTIONS

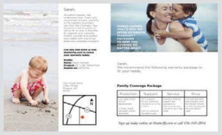
Variable print-on-demand solutions for large enterprises.



TARGETED DIRECT MAIL




JUST-IN-TIME, INVENTORY-FREE PRINTING



PERSONALIZED COMMUNICATION

## 2017 BY THE NUMBERS

**$1.2B** REVENUES

**40B+** HOSTED PHOTOS

**~$38** AVERAGE ORDER VALUE

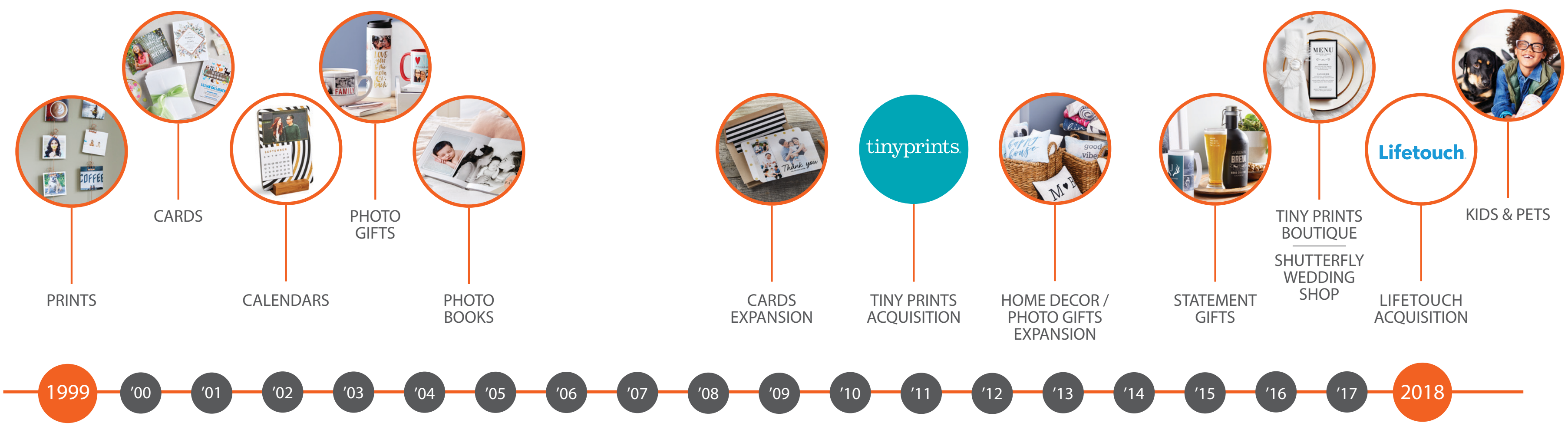
**26M** ANNUAL ORDERS

**~75%** RETURNING CUSTOMERS

**10M** CUSTOMERS

**$190M+** ENTERPRISE REVENUE

## SHUTTERFLY PRODUCT CATEGORY EVOLUTION



## PHASE 1: 2017

### WHAT WE DID

- Focus all of our resources on our largest opportunities.
- Brought the vast majority of Consumer customers and brands onto a single platform.

### WHAT HAPPENED

- Success of platform migration seen in Q4 results - retained majority of revenue and customers from migrating brands.
- Significant cost savings allow both reinvestment and improved bottom line.

## PHASE 2: 2018 TO 2020

### 2018 FOCUS

- Launch Kids and Pets
- Increase personalization and targeting
- Drive mobile monetization
- Expand Enterprise gross margin and pipeline

MAKE PURCHASING PERSONALIZED PRODUCTS SIMPLE


OFFER A BROADER RANGE OF PRODUCTS

PIVOT TO MOBILE


LEVERAGE OUR MANUFACTURING PLATFORM

SHUTTERFLY INC

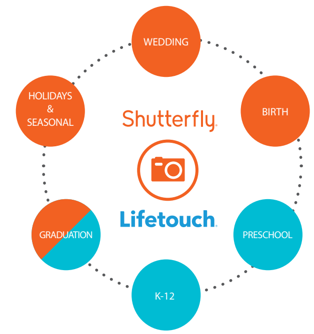
Leader in photo-based products

+

Lifetouch

Leader in school photography

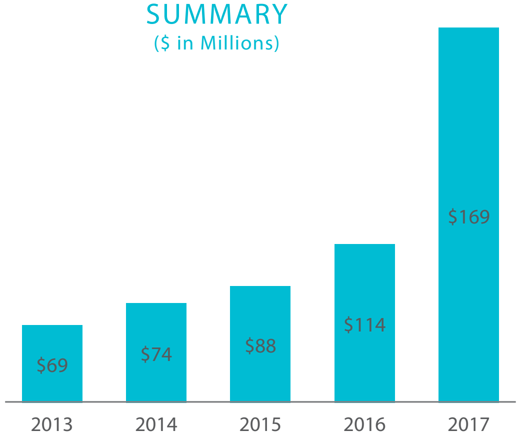
=



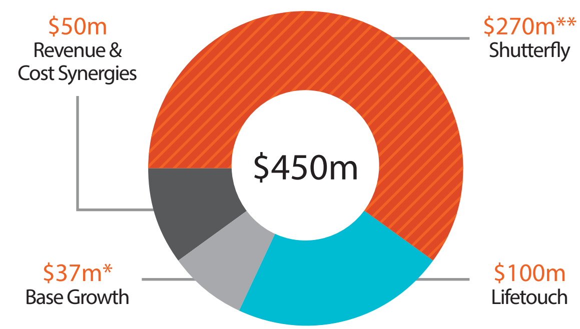

+12%
ADJUSTED EBITDA

+49%
FREE CASH FLOW

### FREE CASH FLOW SUMMARY
($ in Millions)




### 2020 MINIMUM ADJUSTED EBITDA TARGET




*Assumes minimum growth of 5%.
** Mid point of 2018 Shutterfly standalone guidance provided as of January 30, 2018

## 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 and free cash flow. 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.

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 gross margins, 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 that we have not reconciled our 2020 Non-GAAP Adjusted EBITDA target of $450 million to comparable GAAP operating income at this stage of the process because it is unreasonably difficult to provide guidance for stock-based compensation expense, capitalization and amortization of internal-use software and charges related to the proposed acquisition, which are reconciling items between GAAP operating loss and Non-GAAP Adjusted EBITDA. The factors that may impact our future stock-based compensation expense and capitalization and amortization of internal-use software 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 and our inability to project the cost or scope of internally produced software and charges related to the proposed acquisition during this time period.

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

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2015** | **2014** | **2013** |
| **Net income (loss)** | $ 30,085 | $ 15,906 | $ (843) | $ (7,860) | $ 9,285 |
| Add back: | | | | | |
| Interest expense | 27,836 | 23,023 | 20,998 | 16,732 | 9,446 |
| Interest and other income, net | (1,481) | (501) | (744) | (508) | (308) |
| Benefit from (provision for) income taxes | 5,160 | 10,682 | (1,146) | (2,119) | 3,635 |
| Depreciation and amortization | 103,862 | 113,651 | 113,277 | 98,752 | 74,856 |
| Stock-based compensation expense | 43,573 | 45,692 | 60,458 | 61,762 | 53,528 |
| Capital lease termination | 8,098 | — | — | — | — |
| Restructuring | 16,966 | — | — | — | — |
| **Non-GAAP Adjusted EBITDA** | $234,099 | $208,453 | $192,000 | $166,759 | $150,442 |

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

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2015** | **2014** | **2013** |
| **Net cash provided by operating activities** | $239,524 | $193,423 | $165,037 | $166,488 | $147,268 |
| Less: Capital expenditures [1] | 70,751 | 79,860 | 76,669 | 92,201 | 78,342 |
| **Free Cash Flow** | $168,773 | $113,563 | $ 88,368 | $ 74,287 | $ 68,926 |

[1] 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 business plans, objectives, expected operating results and expected Adjusted EBITDA levels. 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, 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; and general economic conditions and changes in laws and regulations. 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 on the Securities and Exchange Commission's website at www.sec.gov. These forward-looking statements are based on current expectations and the Company assumes no obligation to update this information.

# 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)**<br>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: Advisory Vote on Frequency of Vote on Compensation of Named Executive Officers (page 24)**<br>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 principles, and stockholder interests and concerns. We believe the compensation program for the Named Executive Officers was strongly aligned with the long-term interests of our stockholders and was instrumental in helping us achieve strong financial performance in 2017. | **FOR** |
| **Proposal 3: Amendment of 2016 Equity Incentive Plan (pages 50 to 58)**<br>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 59 to 60)**<br>The Board and the Audit Committee believe that the continued retention of PricewaterhouseCoopers LLP for the fiscal year ending December 31, 2018 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** |

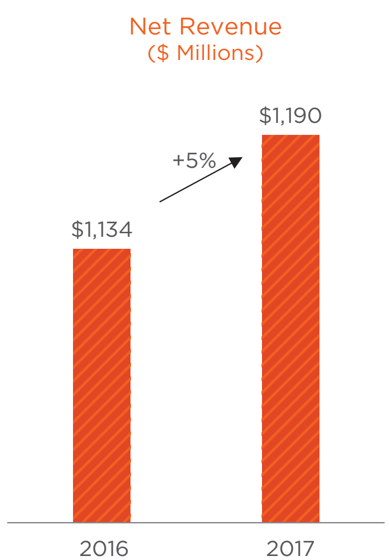
## BUSINESS STRATEGY UPDATE AND 2017 BUSINESS RESULTS

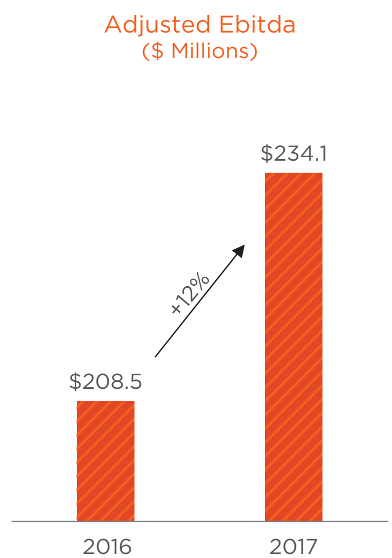
At the beginning of 2017, we refined our business strategy around four key areas of focus:

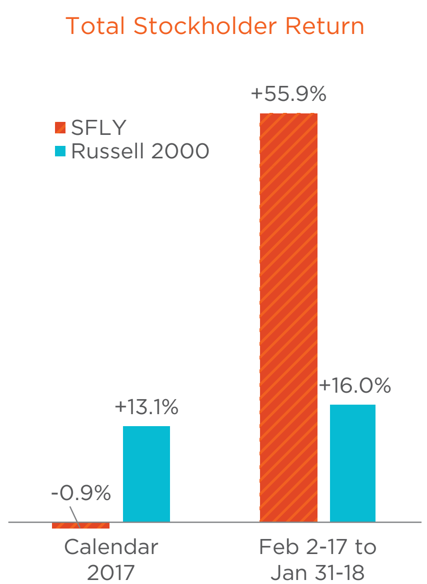
1) simplifying the process of creating and purchasing personalized products
2) expanding the range of products,
3) pivoting to mobile, and
4) leveraging our manufacturing platform for business customers.

As the first step of our long-term strategy, we made the decision to restructure our Consumer business, simplifying our brand portfolio and shifting customers to our flagship Shutterfly.com website. We believed effectively executing our strategy would position the Company to deliver sustainable, profitable growth and create value for our stockholders. We delivered strong results during 2017, setting us up for success in 2018 and beyond (see "2017 Business Results").

Under the leadership of our executive team, we exceeded our plan for 2017, delivering 5% growth in net revenues and 12% growth in Adjusted EBITDA. In addition, after the close of 2017, we announced our agreement to acquire Lifetouch, a national leader in school photography. We are targeting a minimum of $450 million in Adjusted EBITDA by 2020, through the strength of each other's core businesses as well as our realization of unique revenue and cost synergies available from combining our two complementary companies. By executing our long-term strategy, we delivered strong financial performance and created value for our stockholders over the past year. Our 1-year total stockholder return (TSR) over calendar year 2017 was -0.9%. However, we believe it is also relevant to evaluate TSR from the day after the release of our 2016 Fourth Quarter Earnings (February 2, 2017) through the day after the release of our 2017 Fourth Quarter Earnings and Lifetouch acquisition announcement (January 31, 2018). Over this period reflecting when our 2017 financial results were publicly-disclosed, our total stockholder return was 55.9% compared to 16.0% for the Russell 2000 index. For additional information, see pages 25 to 27.



## DIRECTOR NOMINEES AND OTHER DIRECTORS

The following are the Class III Directors who are the nominees for the 2018 Annual Meeting. 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 |
|---|---|---|---|---|---|---|---|---|
| Thomas D. Hughes | 58 | Director | 2015 | 2018 | Yes | | 👥 | 👥 |
| Eva Manolis | 54 | Director | 2016 | 2018 | Yes | | | 👥 |
| Elizabeth Sartain | 63 | Director | 2016 | 2018 | Yes | | 👤 | |

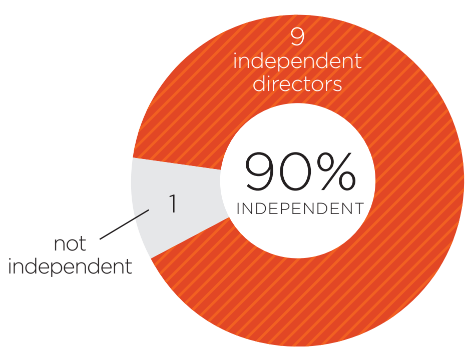
The following are the Class I and Class II Directors who will continue on the Board of Directors after the 2018 Annual Meeting.

| | AGE | TITLE | DIRECTOR SINCE | TERM EXPIRATION | INDEPENDENT | AUDIT | COMPENSATION | GOVERNANCE |
|---|---|---|---|---|---|---|---|---|
| Christopher North | 47 | President and Chief Executive Officer, Director | 2016 | 2019 | | | | |
| William Lansing | 59 | Chairman of the Board, Director | 2017 | 2019 | Yes | | | |
| Ann Mather | 58 | Director | 2013 | 2020 | Yes | | | |
| Elizabeth S. Rafael | 56 | Director | 2016 | 2019 | Yes | 👤 | | |
| H. Tayloe Stansbury | 56 | Director | 2016 | 2020 | Yes | 👥 | | |
| Brian T. Swette | 64 | Director | 2009 | 2020 | Yes | 👥 | | 👤 |
| Michael P. Zeisser | 53 | Director | 2013 | 2019 | Yes | | 👥 | |

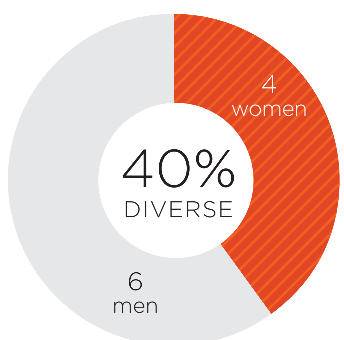
👤 – Chairperson     👥 – Member

## DIRECTOR DASHBOARD

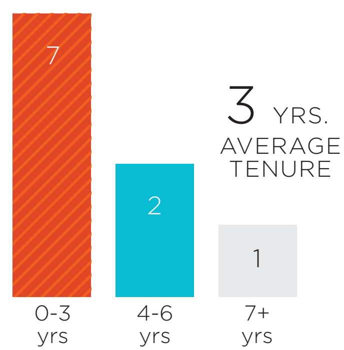
**Independence**



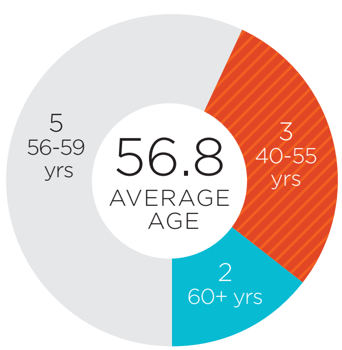

**Gender**




**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 has taken steps to redesign our executive compensation program to support our business strategy and in response to ongoing dialogue with our stockholders. Over the last few 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 simplify our programs over the last two 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.** Pay should be directly linked to performance. Accordingly, a significant portion of 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.** Compensation should incentivize management to achieve short-term results in a manner that also supports our long-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 individuals with greater responsibility, greater ability to influence achievement of our corporate goals and greater accountability for those goals. Furthermore, 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 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 2017 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.

### WHAT WE DO

- **Pay for Performance**. Our program is designed to align executive pay with our financial performance and stockholder value.
- **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 peer group as one of the factors in determining the compensation for our NEOs.
- **CEO Stock Ownership Guideline**. 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 executive officers.

### WHAT WE DON'T DO

- **No Single Trigger Change-in-Control Payments**. No payments or benefits are payable 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.
- **No Hedging, Speculative Trading, or Pledging.** Our trading policies prohibit employees and directors from hedging, speculative trading or pledging of our stock.

# 01

2018 PROXY STATEMENT

INC

# NOTICE OF 2018 ANNUAL MEETING

**Meeting Date & Time**
Wednesday, May 23, 2018
10:30 a.m. PST

**Meeting Place**
Shutterfly, Inc.
2800 Bridge Parkway
Redwood City, California
94065

**Record Date**
March 26, 2018

## DEAR STOCKHOLDER:

Notice is hereby given that the 2018 Annual Meeting of Stockholders (the "Annual Meeting") of Shutterfly, Inc., a Delaware corporation ("we" or "our"), will be held at 2800 Bridge Parkway, Redwood City, California 94065, on May 23, 2018, at 10:30 a.m., Pacific Daylight Time, for the following purposes:

1. To elect three Class III directors to hold office until our 2021 Annual Meeting of Stockholders;
2. To approve, on an advisory basis, the compensation of our named executive officers;
3. To approve the amendment of our 2015 Equity Incentive Plan to increase the number of shares available for issuance thereunder by 900,000 shares;
4. To ratify the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the year ending December 31, 2018; 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").

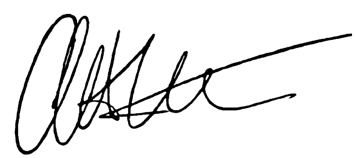
Our Board of Directors recommends that you vote FOR the election of the director nominees named in Proposal No. 1; FOR the proposal regarding our advisory vote on the compensation of our named executive officers in Proposal No. 2; FOR the amendment of our 2015 Equity Incentive Plan as described in Proposal 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 26, 2018 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 13, 2018, 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 13, 2018

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# 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 23, 2018, 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 2800 Bridge Parkway, 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 13, 2018, to stockholders of record as of the close of business on March 26, 2018 (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 13, 2018 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 33,107,322 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 2017, accompanies this Proxy Statement. **You also may obtain a copy of our Annual Report on Form 10-K for fiscal 2017 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 2017 is also available in the "Investor Relations" section of our website at *ir.shutterfly.com*.

# 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 33,107,322 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 III directors to hold office until our 2021 Annual Meeting of Stockholders;
- **Proposal No. 2: FOR** the approval, on an 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 900,000 shares; 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, 2018.

## 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 33,107,322 shares of Common Stock outstanding and entitled to vote. Therefore, in order for a quorum to exist, 16,553,662 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 III nominees or you may "WITHHOLD" your vote for any nominee you specify. For the advisory vote on 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, 2018, 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 New York Stock Exchange 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 2018. 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 III directors, the advisory vote on 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 III directors, the advisory vote on 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 for the purpose of determining 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 Principles, 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—Advisory Vote on Executive Compensation

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 2018. 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 22, 2018. 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 14, 2018. If you wish to submit a proposal for consideration at our 2018 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 February 7, 2019 and no later than March 10, 2019. 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 2800 Bridge Parkway, Redwood City, California 94065, on May 23, 2018, 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 9:45 a.m., Pacific Daylight Time, at 2800 Bridge Parkway, 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 the Nasdaq Stock Market ("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 2018 Annual Meeting of stockholders, three Class III directors are to be elected to serve until our 2021 annual meeting of stockholders, and until their successors are elected and qualified. The terms of our four Class 1 directors and three Class II directors expire at our 2019 and 2020 annual meetings of stockholders, respectively.

The three Class III director nominees are:

**Thomas D. Hughes**
**Eva Manolis**
**Elizabeth (Libby) Sartain**

Each of the nominees is currently a member of our Board. Mr. Hughes was previously elected at the 2015 annual meeting of stockholders. The Board appointed Ms. Manolis in October 2016 and Ms. Sartain in December 2016. 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 Corporate Governance Principles, 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 Principles, 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 have an understanding of corporate governance practices and trends. The biographies of the nominees describe the skills, qualities, attributes and experiences of each of the nominees that led to 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 13, 2018 for each nominee for Class III, Thomas D. Hughes, Eva Manolis and Elizabeth Sartain, director and each person whose term of office as a Class I or II director will continue after the Annual Meeting.

| | AGE | TITLE | INDEPENDENT | AUDIT | COMPENSATION | GOVERNANCE |
|---|---|---|---|---|---|---|
| Christopher North | 47 | President and Chief Executive Officer, Director | | | | |
| William Lansing | 59 | Chairman of the Board, Director | Yes | | | |
| Thomas D. Hughes | 58 | Director | Yes | | Member | Member |
| Eva Manolis | 54 | Director | Yes | | | Member |
| Ann Mather | 58 | Director | Yes | | | |
| Elizabeth S. Rafael | 56 | Director | Yes | Chairperson | | |
| Elizabeth Sartain | 63 | Director | Yes | | Chairperson | |
| H. Tayloe Stansbury | 56 | Director | Yes | Member | | |
| Brian T. Swette | 64 | Director | Yes | Member | | Chairperson |
| Michael P. Zeisser | 53 | 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

| | |
|---|---|
| Senior Leadership | 6 |
| Finance | 6 |
| Brand Marketing/Advertising | 3 |
| Global/International | 8 |
| Industry Experience | 8 |
| Operational Experience | 7 |
| Technology Infrastructure/Network Engineering | 3 |
| Corporate Governance/Legal | 4 |
| Cybersecurity | 3 |

## THOMAS D. HUGHES

**Age:** 58

**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.

Marathon Partners L.P. (“Partners LP”) paid Mr. Hughes $10,000 in cash upon submission of his nomination to serve as a nominee to the Board of Directors and an additional $10,000 in cash upon the filing of a definitive proxy statement with the Securities and Exchange Commission by Partners LP relating to the solicitation of proxies or written consents for the election of Partners LP’s nominees to our Board of Directors at our 2015 annual meeting of stockholders. Pursuant to Mr. Hughes’ arrangement with Partners LP, Mr. Hughes agreed to use the after-tax proceeds from such compensation to acquire shares of our Common Stock at such time that Mr. Hughes shall determine, and Mr. Hughes agreed not to sell, transfer or otherwise dispose of any such shares within two years of his election as a director, except in accordance with the terms of a business combination.

**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:** 54

**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 (LIBBY) SARTAIN

**Age:** 63

**Director since:** 2016

**EXPERIENCE:** Elizabeth (Libby) 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.

## WILLIAM J. LANSING

**Age:** 59

**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.

## CHRISTOPHER NORTH

**Age:** 47

**Director since:** 2016

**EXPERIENCE:** Christopher North has served as our President and Chief Executive Officer and on our Board of Directors since May 2016. 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.

**QUALIFICATIONS:** Mr. North received a Bachelor of Arts in Economics from Harvard College and a Master of Arts in Philosophy from New York University. Mr. North serves as our Chief Executive Officer and therefore brings to the Board his knowledge of all aspects of our business, as well as extensive experience in the publishing and e-commerce industries.

## ELIZABETH S. RAFAEL

**Age:** 56

**Director since:** 2016

**EXPERIENCE:** Elizabeth S. Rafael has served on our Board of Directors since June 2016. 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, Autodesk, Inc., a multinational software company, since September 2013, and GoDaddy Inc., an Internet domain registrar and web hosting company, since March 2014, and previously served on the board of directors of 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:** 53

**Director since:** 2013

**EXPERIENCE:** Michael P. Zeisser has served on our Board of Directors since March 2013. Mr. Zeisser has served as Chairman, US Investments for Alibaba Group Holding Ltd., one of the largest Internet companies in the world, since October 2013. 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. Mr. Zeisser currently serves on the board of directors of XO Group, Inc., a consumer Internet company. During the past five 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, and IAC/Interactive Corp, a digital media and eCommerce 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:** 56

**Director since:** 2016

**EXPERIENCE:** H. Tayloe Stansbury has served on our Board of Directors since December 2016. Mr. Stansbury has almost 35 years of experience at various technology companies. Mr. Stansbury currently serves 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 serves on the board of directors of Coupa Software Inc., a cloud-based platform for business spend, since September 2015 and previously served on the board 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:** 64

**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 currently serves 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.

There are no family relationships among any of our directors and executive officers.

## EXECUTIVE OFFICERS

The following is biographical information for our executive officers, other than Mr. North, our Chief Executive Officer, as of April 13, 2018.

| NAME | AGE | POSITION |
|---|---|---|
| Michele Anderson | 52 | Senior Vice President, Retail |
| Scott Arnold | 54 | Senior Vice President, Enterprise |
| Dwayne Black | 50 | Senior Vice President and Chief Operations Officer |
| Tracy Layney | 45 | Senior Vice President and Chief Human Resources Officer |
| Ishantha Lokuge | 51 | Senior Vice President and Chief Product Officer |
| Satish Menon | 60 | Senior Vice President and Chief Technical Officer |
| Michael Pope | 51 | Senior Vice President and Chief Financial Officer |

### MICHELE ANDERSON

**Age:** 52

**Executive Officer since:** 2017

**EXPERIENCE:** Michele Anderson has served as our Senior Vice President, Retail since February 2017. Ms. Anderson joined Shutterfly from Activate Inc., a specialist advisory firm that develops and implements growth strategies and builds new digital-first businesses, where she served as Chief Operating Officer and Managing Director from 2010 to 2017. Prior to Activate, from 2003 to 2010, Ms. Anderson held the role of General Manager, North America, at Australian Vintage Ltd., an Australian wine company. Prior to Australian Vintage, Ms. Anderson held senior roles at iVillage Inc., a media company, and Booz Allen & Hamilton, a management consulting firm. Ms. Anderson serves on the board of directors of a private UK-based company.

Ms. Anderson has a Bachelor of Commerce and Bachelor of Law from the University of New South Wales and an M.B.A from the Wharton Business School.

### SCOTT ARNOLD

**Age:** 54

**Executive Officer since:** 2017

**EXPERIENCE:** Scott Arnold has served as our Senior Vice President, 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 deployment 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 the Board of Directors of MetricStream and on Duke University's Pratt School of Engineering Board of Visitors.

Mr. Arnold has a Bachelor of Science in Electrical Engineering from Duke University and an M.B.A from the Stanford Graduate School of Business.

## DWAYNE BLACK

**Age:** 50

**Executive Officer since:** 2007

**EXPERIENCE:** Dwayne Black has been with Shutterfly since February 2007 and is currently serving as our Senior Vice President, Chief Operations Officer. 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.

## TRACY LAYNEY

**Age:** 45

**Executive Officer since:** 2015

**EXPERIENCE:** Tracy Layney joined Shutterfly in June 2015 as Senior Vice President and Chief Human Resources Officer and 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:** 51

**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:** 60

**Executive Officer since:** 2014

**EXPERIENCE:** Satish Menon has served as our Senior Vice President and Chief Technical Officer since November 2014. Mr. 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, Mr. 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, Mr. Menon served as Vice President of the Consumer Platforms Group at Yahoo! Inc.. Mr. Menon also held technology leadership positions at Kasenna, Inc., a video on demand company, from 2000 to 2006 and Silicon Graphics, Inc. from 1994 to 2000. Mr. 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.

Mr. 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.

## MICHAEL POPE

**Age:** 51

**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 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 is 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 2017, our Board of Directors and its committees held 27 meetings (including regularly scheduled and special meetings), and each current director attended at least 75% 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 |
|---|---|---|---|
| William Lansing | | | |
| 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 2017** | **7** | **7** | **5** |

= Chairperson = Member

* William J. Lansing, 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

At the January 23, 2018 meeting of the Board of Directors, the Board approved a revision to the name of the Shutterfly Compensation and Leadership Development Committee to the Compensation and Leadership Development Committee (the "Compensation and Leadership

Development Committee") as this name more accurately reflects the responsibilities of this Committee. The Compensation and Leadership Development 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 Compensation and Leadership Development 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 chief executive officer and other 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 Compensation and Leadership Development Committee on an annual basis, including the adequacy of the Compensation and Leadership Development Committee charter. The Compensation and Leadership Development Committee engages outside consultants to provide compensation data and consulting services. In 2017, the Compensation and Leadership Development Committee engaged Frederic W. Cook & Co., Inc. as an outside consultant. The Compensation and Leadership Development 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 Compensation and Leadership Development Committee is determined by its chair with the assistance of our Chief Executive Officer and Senior Vice President, Chief Human Resources Officer. Compensation and Leadership Development Committee meetings are regularly attended by the Chief Executive Officer and the Senior Vice President, Chief Human Resources Officer. The Compensation and Leadership Development Committee's chair reports its recommendations on executive compensation to the Board. The Compensation and Leadership Development Committee reviews the total fees paid to outside consultants to ensure that the consultant maintains its objectivity and independence when rendering advice to the Compensation and Leadership Development Committee.

The Board has determined that each member of the Compensation and Leadership Development 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 2017, 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 2017 was at any time during 2017 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 2017.

## 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 the composition and performance of the Governance Committee, 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 Compensation and Leadership Development Committee considers risk in connection with its design of compensation programs for our executives. 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 Principles. 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 26, 2018 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 33,107,322 shares of our Common Stock outstanding as of March 26, 2018. 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 26, 2018 (i.e., by May 25, 2018) 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) | 5,059,482 | 15.3% |
| BlackRock, Inc. (2) | 4,127,633 | 12.5% |
| The Vanguard Group (3) | 3,009,168 | 9.1% |
| Park West Asset Management, LLC (4) | 1,811,637 | 5.5% |
| Thomas D. Hughes (5) | 8,565 | • |
| William Lansing (6) | 27,124 | • |
| Eva Manolis (7) | 6,986 | • |
| Ann Mather (8) | 7,868 | • |
| Christopher North (9) | 249,685 | • |
| Elizabeth S. Rafael (10) | 8,615 | • |
| Elizabeth Sartain (11) | 6,627 | • |
| H. Tayloe Stansbury (12) | 6,025 | • |
| Brian T. Swette (13) | 27,765 | • |
| Michael P. Zeisser (14) | 20,161 | • |
| Michele Anderson (15) | 6,020 | • |

| NAME OF BENEFICIAL OWNER | SHARES OF COMMON STOCK BENEFICIALLY OWNED | |
|---|---|---|
| | NUMBER | PERCENTAGE |
| Scott Arnold (16) | — | • |
| Dwayne A. Black (17) | 22,886 | • |
| Tracy Layney (18) | 2,095 | • |
| Ishantha Lokuge (19) | 2,513 | • |
| Satish Menon (20) | 3,980 | • |
| Michael Pope (21) | 24,616 | • |
| All current directors and executive officers as a group (17 persons) | | 1.3% |

• 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 27, 2018 that, of the 5,059,482 shares beneficially owned by it, it has (a) sole voting power over 4,375,427 shares, and (b) sole dispositive power over 5,059,482 shares. According to the 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 19, 2018 that, of the 4,127,633 shares beneficially owned by it, it has (a) sole voting power over 4,052,276 shares and (b) sole dispositive power over 4,127,633 shares. According to the 13G/A filing, the address 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 12, 2018 that, of the 3,009,168 shares beneficially owned by it, it has (a) sole voting power over 64,604 shares, (b) shared voting power over 4,518 shares, (c) sole dispositive power over 2,942,846 shares, and (d) shared dispositive power over 66,322 shares. According to the Schedule13G/A filing, the address of The Vanguard Group Inc. is 100 Vanguard Blvd., Malvern, PA 19355.

(4) Based solely on Schedule 13G/A filed with the SEC on February 14, 2018, reporting beneficial ownership as of December 31, 2017, Park West Asset Management, LLC. and Peter S. Park, as the sole member and manager of Park West Asset Management, LLC, reported beneficial ownership of the 1,811,637 shares. Of the 1,811,637 beneficially owned shares, it has (a) shared voting power over 1,811,637 shares and (b) shared dispositive power over 1,811,637 shares. According to the 13G/A filing, the address of Park West Asset Management, LLC. is 900 Larkspur Landing Circle, Suite 165, Larkspur, California 94939.

(5) Consists of 4,625 shares of common stock over which Mr. Hughes has sole voting and dispositive power and 3,940 RSUs eligible for vesting within 60 days of March 26, 2018.

(6) Consists of 21,510 shares of common stock over which Mr. Lansing has sole voting and dispositive power and 5,614 RSUs eligible for vesting within 60 days of March 26, 2018.

(7) Consists of 3,046 shares of common stock over which Ms. Manolis has sole voting and dispositive power and 3,940 RSUs eligible for vesting within 60 days of March 26, 2018.

(8) Consists of 3,928 shares of common stock over which Ms. Mather has sole voting and dispositive power and 3,940 RSUs eligible for vesting within 60 days of March 26, 2018.

(9) Consists of 12,394 shares of common stock over which Mr. North has sole voting and dispositive power and 237,291 shares subject to options that are exercisable within 60 days of March 26, 2018.

(10) Consists of 3,986 shares of common stock over which Ms. Rafael has sole voting and dispositive power and 4,629 RSUs eligible for vesting within 60 days of March 26, 2018.

(11) Consists of 2,293 shares of common stock over which Ms. Sartain has sole voting and dispositive power and 4,334 RSUs eligible for vesting within 60 days of March 26, 2018.

(12) Consists of 2,085 shares of common stock over which Mr. Stansbury has sole voting and dispositive power and 3,940 RSUs eligible for vesting within 60 days of March 26, 2018.

(13) Consists of 23,825 shares of common stock over which Mr. Swette has sole voting and dispositive power and 3,940 RSUs eligible for vesting within 60 days of March 26, 2018.

(14) Consists of 16,221 shares of common stock over which Mr. Zeisser has sole voting and dispositive power and 3,940 RSUs eligible for vesting within 60 days of March 26, 2018.

(15) Consists of 6,020 shares subject to options that are exercisable within 60 days of March 26, 2018. Ms. Anderson joined Shutterfly on February 27, 2017.

(16) Mr. Arnold joined Shutterfly on June 30, 2017.

(17) Consists of 19,535 shares of common stock over which Mr. Black has sole voting and dispositive power and 3,351 shares subject to options that are exercisable within 60 days of March 26, 2018.

(18) Consists of 2,095 shares subject to options that are exercisable within 60 days of March 26, 2018.

(19) Consists of 2,513 shares subject to options that are exercisable within 60 days of March 26, 2018.

(20) Consists of 3,980 shares subject to options that are exercisable within 60 days of March 26, 2018.

(21) Consists of 24,616 shares subject to options that are exercisable within 60 days of March 26, 2018.

# 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 2017, all Section 16(a) filing requirements applicable to our officers, directors and greater than 10 percent beneficial owners were timely met except that the following forms were inadvertently filed late: Form 4s for Lisa Blackwood-Kapral to report a new grant of RSUs; and a Form 4 for William Lansing to report the purchase of common stock.

# PROPOSAL NO. 2 ADVISORY VOTE TO APPROVE THE COMPANY'S EXECUTIVE COMPENSATION

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.

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 principles, and stockholder interests and concerns. We believe the compensation program for the Named Executive Officers was strongly aligned with the long-term interests of our stockholders and was instrumental in helping us achieve strong financial performance in 2017.

Accordingly, we are asking you to approve, on an 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.

The following resolution is hereby submitted for a stockholder vote at the Annual Meeting:

"RESOLVED, that the stockholders of Shutterfly approve, on an advisory basis, the compensation of Shutterfly's Named Executive Officers, as disclosed in the "Compensation Discussion and Analysis," the compensation tables and the related narrative discussion of the Proxy Statement pursuant to the compensation disclosure rules of the Securities and Exchange Commission."

Although the advisory vote is non-binding, the Compensation and Leadership Development Committee and the Board will review the results of the vote. The Compensation and Leadership Development Committee will consider our stockholders' concerns to the extent there is any significant vote against the compensation of our Named Executive Officers as disclosed in this Proxy Statement and take them into account in future determinations concerning our executive compensation program. The Board therefore recommends that you indicate your support for the compensation of the Named Executive Officers, as described in this Proxy Statement, and recommends that our stockholders should cast an advisory vote on the compensation of our Named Executive Officers on an annual basis as was approved by the stockholders in a non-binding advisory vote at the 2017 Annual Meeting. Our next advisory vote on the compensation of our Named Executive Officers will be at the 2019 Annual Meeting of Stockholders.

**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 AND THE RELATED NARRATIVE DISCUSSION OF THIS PROXY STATEMENT.**

# COMPENSATION DISCUSSION AND ANALYSIS

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This Compensation Discussion and Analysis ("CD&A") provides a detailed description of our compensation philosophy, practices, and the factors and process used in making compensation decisions with respect to our named executive officers for the year ended December 31, 2017 ("NEOs"). Our NEOs are:

- Christopher North, President and Chief Executive Officer ("CEO");
- Michael Pope, Senior Vice President and Chief Financial Officer ("CFO");
- Michele Anderson, Senior Vice President, Retail;
- Scott Arnold, Senior Vice President, Enterprise; and
- Satish Menon, Senior Vice President and Chief Technology Officer.

## EXECUTIVE SUMMARY

Overview. As the leading provider and online retailer of high-quality personalized products and services offered through our lifestyle brands, 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. At the beginning of 2017, we refined our business strategy around four key areas of focus: 1) simplifying the process of creating and purchasing personalized products, 2) expanding the range of products, 3) pivoting to mobile, and 4) leveraging our manufacturing platform for business customers. As the first step of our long-term strategy, we made the decision to restructure our Consumer business, simplifying our brand portfolio and shifting customers to our flagship Shutterfly.com website. We believed effectively executing our strategy would position the Company to deliver sustainable, profitable growth and create value for our stockholders. We delivered strong results during 2017, setting us up for success in 2018 and beyond (see "2017 Business Results").

Compensation Program Changes. Our Compensation and Leadership Development Committee ("Committee") has taken steps to redesign our executive compensation program to support our business strategy and in response to ongoing dialogue with our stockholders. Over the last few 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 simplify our programs over the last two years have been effective in driving stockholder value creation. Below is a summary of key feedback and changes:

## WHAT WE HEARD:

1. IMPROVE QUALITY OF EARNINGS AND DELIVER PROFITABLE GROWTH

## WHAT WE DID:

- Changed our bonus plan for 2017 to be based only on Adjusted EBITDA, which now provides clarity of focus on profitability for the executive team and our broader employee base
- Carefully managed our overall equity compensation program, reducing stock-based compensation expense by 27% from 2015 to 2017
- Outside of the compensation program, we have also focused on financial discipline and become more strategic in our investments on high-value initiatives, reducing capital expenditures as a percent of revenue by 20% over the last two years

## WHAT WE HEARD:

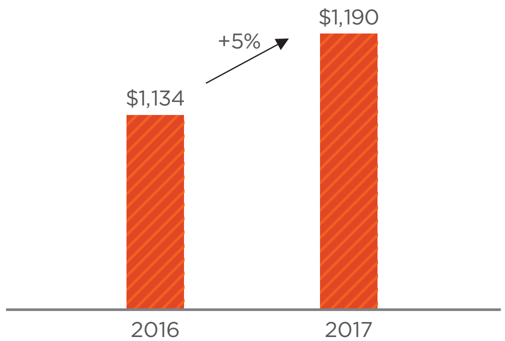
2. TIE LONG-TERM INCENTIVES TO VALUE CREATION FOR STOCKHOLDERS

## WHAT WE DID:

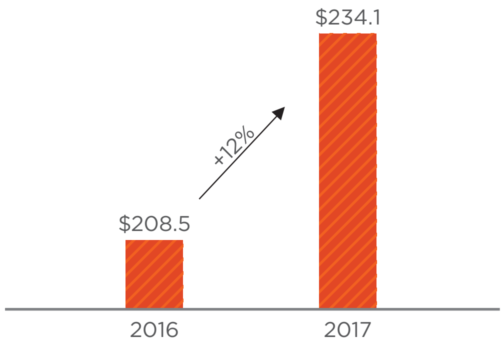
- Changed the performance-based component of our long-term incentive program from RSUs tied to 1-year Adjusted EBITDA goals to stock options, first with our CEO's 2016 hiring award and then for our other NEOs in their 2017 annual grants. Our Board, as well as several key stockholders, views stock options as an effective, performance-based long-term incentive vehicle. Our overall compensation program emphasizes a long-term orientation with near-term financial and operational discipline.

2017 Business Results. Under the leadership of our executive team, we exceeded our plan for 2017, delivering 5% growth in net revenues and 12% growth in Adjusted EBITDA. In addition, after the close of 2017, we announced our agreement to acquire Lifetouch, a national leader in school photography. We are targeting a minimum of $450 million in Adjusted EBITDA by 2020, through the strength of each other's core businesses as well as our realization of unique revenue and cost synergies available from combining our two complementary companies. By executing our long-term strategy, we delivered strong financial performance and created value for our stockholders over the past year. Our 1-year total stockholder return (TSR) over calendar year 2017 was -0.9%. However, we believe it is also relevant to evaluate TSR from the day after the release of our 2016 Fourth Quarter Earnings (February 2, 2017) through the day after the release of our 2017 Fourth Quarter Earnings and Lifetouch acquisition announcement (January 31, 2018). Over this period reflecting when our 2017 financial results were publicly-disclosed, our total stockholder return was 55.9% compared to 16.0% for the Russell 2000 index.

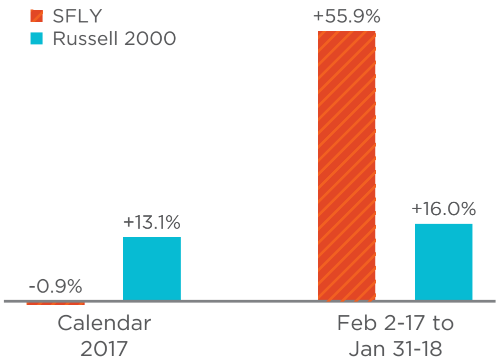
**Net Revenue ($ Millions)**




**Adjusted EBITDA ($ Millions)**




**Total Stockholder Return**




Key 2017 Decisions and Pay Outcomes. Our executive compensation program for 2017 reflects a simplified program consisting principally of base salaries, short-term cash incentives, and long-term incentives:

- **Base Salary:** The Committee awarded no base salary increases for incumbent NEOs. Salaries for our two new-hire NEOs were set in connection with their hire based on arms-length negotiation and consideration of market data and internal equitability.
- **Short-Term Incentive Compensation:** For 2017, the Committee set our Adjusted EBITDA goal at $230 million, which represented a 10.3% increase over 2016 results. We exceed our goal and NEO bonuses were earned at 122% of target.
- **Long-term Incentive Compensation:** The Committee balanced performance-based and fixed-awards by granting annual awards to our NEOs as approximately 50% stock options and 50% RSUs. No award was granted to our CEO because he was provided a multi-year grant upon hire. One other NEO, Mr. Menon, was also provided a retention RSU award in addition to his annual award of stock options and RSUs.

## 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 two-part vision describes our intention to be the leader in our field in both the consumer and enterprise sides of our business. On the consumer side, we aim to help people share life's joy by being the leading online retailer and provider of high-quality personalized products, complemented by our enterprise vision to be the leading digital manufacturing platform for business.

- **Our Values**: We act as owners. We invest in the long-term while delivering results today. We use data and insights to inform decisions. We passionately innovate on behalf of our customers. We inspire customers through creativity and beautiful design. We do the right thing for customers. We are warm, inclusive, and collaborative. We invest in great talent. We debate the most important decisions, then fully commit. We share life's joy.
- **Our Strategies***:* We have articulated four primary strategies for the next three to five years that support our long-term vision: (1) making purchasing personalized products simple; (2) offering customers a broader range of products; (3) pivoting towards mobile; and (4) leveraging our manufacturing platform.
- **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**. Pay should be directly linked to performance. Accordingly, a significant portion of 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**. Compensation should incentivize management to achieve short-term results in a manner that also supports our long-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 individuals with greater responsibility, greater ability to influence achievement of our corporate goals and greater accountability for those goals. Furthermore, 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.

Over the last two years, the Committee reviewed how our executive compensation program aligns with the foregoing philosophy, including the selection of performance metrics in annual and long-term incentive compensation programs. In the compensation package for our CEO, the Committee focused on aligning compensation with stock price growth instead of a specific financial measure to directly link compensation value with increases in stockholder value. This was carried through to the equity awards for the rest of our NEOs in 2017.

## 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.
- **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 peer group as one of the factors in determining the compensation for our NEOs.
- **CEO Stock Ownership Guideline**. 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 executive officers.

### WHAT WE DON'T DO

- **No Single Trigger Change-in-Control Payments**. No payments or benefits are payable 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.
- **No Hedging, Speculative Trading, or Pledging.** Our trading policies prohibit employees and directors from hedging, speculative trading or pledging of our stock.

## 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. 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 discussions, the Committee met in executive session without our CEO or other management present. The Committee made all relevant decisions for 2017 compensation for our NEOs. The Committee reviews compensation for our NEOs at least annually.

The factors considered by the Committee in determining the compensation of our NEOs for 2017 included:

- Shutterfly's performance and the NEOs individual performance;
- Market data on compensation at comparable companies;
- Recommendations of our CEO (except with respect to his own compensation);
- Expected future contribution of the individual NEO;
- Retention;
- 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. Our CEO annually evaluates the performance of each of our executive officers, including the other NEOs, based on one or more individual performance objectives established at the beginning of the year. Using his subjective 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, he 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, in order 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 only two of several factors that the Committee considers in making its decisions with respect to the compensation of our NEOs. 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. During 2017, the Committee retained Frederic W. Cook & Co., Inc. ("FW Cook"), a national executive compensation consulting firm, as its independent compensation consultant. FW Cook 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 Committee assessed the independence of FW Cook and determined that no conflicts of interests existed.

Stockholder "Say on Pay" Vote. We hold an annual "Say on Pay" vote for our stockholders to affirm our executive compensation program. At our 2017 Annual Meeting of Stockholders, stockholders representing only 53.4% of the votes cast supported our annual "Say on Pay" resolution. Leading up to and following this vote, we have undertaken extensive stockholder outreach to discuss the pay-for-performance nature of our executive compensation program, as well as to gain a better understanding of our stockholders' views. These discussions highlighted the multi-year nature of our CEO's 2016 new-hire equity award. Based on our ongoing stockholder engagement and review of our compensation policies and decisions, 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 our "Say on Pay" votes and our stockholders' views when making future 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 peer group based on the recommendation of its independent 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.

In late 2016, the Committee approved changes to the peer group to reposition Shutterfly near the median of our peer group by revenue and market cap. The peer group for 2017 was comprised of companies similar to Shutterfly on the basis of revenue, market capitalization, industry (focused on e-commerce, Internet, and software companies), and geography (focused on the San Francisco Bay Area and other major metropolitan markets). This data is supplemented with data from a survey of executive compensation by Radford Associates, a unit of Aon Hewitt, representing both public and private technology companies that are of similar size with revenues between $500 million and $3 billion. Our peer group for 2017 was comprised of the following companies:

**2017 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 table below shows how Shutterfly compares to the peer group used in 2017:

| | REVENUE – LATEST DISCLOSED FOUR QUARTERS AS OF 12/31/2017(1) | MARKET CAPITALIZATION AS OF 12/31/2017(1) |
|---|---|---|
| 75th Percentile | $1,556 | $6,375 |
| Median | $ 861 | $3,382 |
| 25th Percentile | $ 479 | $1,419 |
| Shutterfly | $1,190 | $1,633 |

(1) Expressed in millions.

## Compensation Program Elements

Our executive compensation program is 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 provide base salaries to provide executives with a competitive level of fixed, short-term compensation. The Committee sets the annual base salaries of our NEOs 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 takes into account each NEO's qualifications and experience, position and scope of responsibilities, external pay benchmarks, internal pay equity, and job performance. Salary reviews are conducted annually; however, individual salaries are not necessarily adjusted each year. For 2017, salaries for incumbent NEOs (Messrs. North, Pope and Menon) were maintained at 2016 levels. The salaries for Ms. Anderson and Mr. Arnold were set at the time of their hire.

| NEO | 2016 BASE SALARY | 2017 BASE SALARY | PERCENTAGE ADJUSTMENT |
|---|---|---|---|
| Mr. North | $700,000 | $700,000 | 0.0% |
| Mr. Pope | 415,000 | 415,000 | 0.0% |
| Ms. Anderson | N/A | 350,000 | N/A |
| Mr. Arnold | N/A | 350,000 | N/A |
| Mr. Menon | 375,000 | 375,000 | 0.0% |

Short-term Performance-based Incentive Program. We use cash bonuses to reward the performance of executive officers, including our NEOs, for their contributions to our overall corporate financial and operational performance for the current fiscal year. We evaluate and reward the performance of our executive officers based on quarterly performance periods because the Committee has determined this is the most efficient method to set rigorous goals in the face of significant seasonality on our business.

For 2017, we redesigned and simplified our short-term incentive plan to be based solely on Adjusted EBITDA to encourage a singular focus on increasing profitability as we undertook initiatives to consolidate our consumer brands and position the Company for profitable growth.

| | 2016 PLAN | 2017 PLAN |
|---|---|---|
| Goal Setting | Quarterly | Annual |
| Performance Period | Quarterly | Quarterly |
| Financial Metrics | Adjusted EBITDA (threshold), Revenue | Adjusted EBITDA |
| Individual Performance | Modifier up to +/- 50% | No adjustment for individual performance |

## Individual Bonus Targets

Under the 2017 Bonus Plan, the annual target cash bonus opportunities were set at 100% of base salary for our CEO and 40% of base salary for the other NEOs. Bonus opportunities for Ms. Anderson and Mr. Arnold were pro-rated as of their hire date. In addition, the annual target cash bonus opportunities for all participants were weighted by fiscal quarter at 20% of the target annual cash bonus opportunity for each of the first three fiscal quarters of 2017, 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 2017 Bonus Plan could range from 0% to 200% of the target award in total, but payouts during the first three quarters were capped at 100% of target with above-target amounts held-back and contingent on exceeding the full-year plan.

## Financial Metrics

The 2017 performance goals for Adjusted EBITDA were developed based on recent historical financial performance, planned strategic initiatives, and the then-existing economic environment. The 2017 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 2017 Bonus Plan would be made only if warranted by our actual financial and operational performance, consistent with our pay-for-performance philosophy.

The sum of the quarterly Adjusted EBITDA goals for 2017 represents an aggregate 10% increase from 2016. The Adjusted EBITDA threshold performance levels set by the Committee under the 2017 Bonus Plans are detailed below (amounts shown in millions):

| PERIOD | PERIOD WEIGHTING | 2016 ACTUAL ADJUSTED EBITDA ($ MIL.) | 2017 ADJUSTED EBITDA GOAL ($ MIL.) | 2017 ACTUAL ADJUSTED EBITDA ($ MIL.) (1) | 2017 BONUS FUNDING |
|---|---|---|---|---|---|
| First Quarter | 20% | -$ 2.6 | -$ 4.4 | -$ 1.9 | 100%(2) |
| Second Quarter | 20% | 18.2 | 17.4 | 17.4 | 98% |
| Third Quarter | 20% | -2.0 | 3.0 | 3.0 | 100% |
| Fourth Quarter | 40% | 194.8 | $ 214.0 | 215.6 | 156%(2) |
| **Total** | | **$ 208.5** | **$ 230.0** | **$ 234.1** | **122%** |

(1) Excludes $17 million of restructuring charges relating to our single platform migration and capital lease termination charges related to the HP printer upgrade of $8.1 million.

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

## Bonus Decisions

At each of its quarterly meetings where it reviewed our financial results for purposes of the 2017 Bonus Plan, the Committee considered the potential bonus payments for each of our executive officers, including our NEOs. The following table presents the quarterly bonus payments that were made to the NEOs under the 2017 Bonus Plan.

| NEO | Q1 | Q2 | Q3 | Q4 | TOTAL | % SAL. | % TARGET |
|---|---|---|---|---|---|---|---|
| Mr. North | $140,000 | $137,200 | $140,000 | $439,600 | $856,800 | 122% | 122% |
| Mr. Pope | 33,200 | 32,536 | 33,200 | 104,248 | 203,184 | 49% | 122% |
| Ms. Anderson | 10,360(1) | 27,440 | 28,000 | 87,920 | 153,720 | 44% | 122% |
| Mr. Arnold | N/A | N/A | 28,000 | 87,920 | 115,920 | 33% | 122% |
| Mr. Menon | 30,000 | 29,400 | 30,000 | 94,200 | 183,600 | 49% | 122% |

(1) Pro-rated to Ms. Anderson's start date.

**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. In 2015 and 2016, the Committee undertook a comprehensive review of our long-term incentive program and approved changes that were reflected in both 2016 and 2017 compensation decisions. The primary change was to replace our performance-based RSU awards ("PBRSU") with grants of stock options, first in the 2016 new-hire package for our CEO, and then in 2017 annual equity awards for our other NEOs. In approving the change, the Committee determined that options provide an excellent compensation mechanism for motivating our NEOs to create sustainable long-term stockholder value (and conversely, no reward if we do not create value for stockholders). The Committee considers options to be inherently performance-based because our NEOs will only realize value if our share price increases and they continue to serve through the vesting period applicable to the stock option grants. The decision to replace PBRSUs with stock options was based in part on the Committee's review of long-term incentive practices within our peer group and feedback we received from our stockholders during outreach meetings.

In determining the amount of the long-term incentive compensation awards the Committee considers a number of reference points, including the NEO's performance, the NEO's then-current total direct compensation (i.e., the sum of base salary, target cash bonuses and the annualized 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 the NEO's outstanding equity awards, and the NEO'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 NEOs with stockholder interests, and maximize executive retention. The Committee does not place any specific weight on these factors, nor does it apply a formula to determine the amounts awarded.

## 2017 Equity Awards

In February 2017, the Committee approved annual equity awards for our incumbent NEOs other than our CEO. These equity awards consisted of stock option and RSU awards. The award mix was set at approximately 50% stock options and 50% RSUs by value, to balance increases for growth with ongoing retention. Additionally, in February 2017, the Committee approved a supplemental RSU grant for Mr. Menon for retention purposes.

In connection with their hires, Ms. Anderson and Mr. Arnold were provided hiring awards, also in an approximate value mix of 50% stock options and 50% RSUs.

The equity awards granted to the NEOs were as follows:

| NEO | ANNUAL / NEW HIRE SHARE TOTALS: STOCK OPTION AWARDS (NO.) | ANNUAL / NEW HIRE SHARE TOTALS: RSU AWARDS (NO.) | RETENTION RSU AWARDS (NO.) | AGGREGATE GRANT DATE FAIR VALUE OF EQUITY AWARDS ($) |
|---|---|---|---|---|
| Mr. North | — | — | — | — |
| Mr. Pope | 78,771 | 23,500 | — | 1,994,908 |
| Ms. Anderson | 144,483 | 48,161 | — | 3,996,140 |
| Mr. Arnold | 157,894 | 50,170 | — | 4,392,544 |
| Mr. Menon | 63,687 | 19,000 | 10,000 | 2,060,402 |

The stock option awards were granted with exercise price equal to the closing price on the date of grant, have a seven-year term, and are subject to a four-year vesting schedule with 25% vesting on the first anniversary of the grant date and in equal monthly installments thereafter. The annual and new-hire RSU awards vest over four years in 25% installments on each anniversary of the grant date. The retention RSU award provided to Mr. Menon vests 100% on the 2nd anniversary of the grant date.

## 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 do not currently provide Company matching contributions to our 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.

*Perquisites and Other Personal Benefits.* 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. Mr. North is eligible to be reimbursed for up to $15,000 annually in tax planning expenses through his third year of employment.

*Sign-On Transition Bonuses*. In connection with their hires and as an inducement to join the Company, Ms. Anderson and Mr. Arnold were provided sign-on bonuses of $500,000. Ms. Anderson's sign-on bonus was to be paid 50% following her start date, then in equal monthly installments during her second year of employment. Mr. Arnold's sign-on bonus was to be paid in 50% installments following his start date and on the first anniversary of his start date. The bonuses are subject to pro-rata repayment upon resignation or termination for cause during the first two years of employment.

## TERMINATION AND CHANGE IN CONTROL ARRANGEMENTS

To enable us to attract talented executives, 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 benefits are generally standard for NEOs other than the CEO and included in each executive's Retention Agreement and Amended Retention Agreements (each as defined under the heading "Executive Compensation Tables—Potential Payments upon Termination or Change in Control"); the CEO's benefits were negotiated at the time of hire. We believe these arrangements reinforce the commitment of our executives 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 period. Payment of any severance benefits requires termination of employment (i.e., we have no "single-trigger" severance or equity vesting provisions that are contingent solely on occurrence of a change in control ("CIC")). In addition, we do not provide 280G excise tax gross-up payments. For a summary of the material terms and conditions of the severance and change in control agreements in effect as of December 31, 2017, 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 guidelines are designed to encourage our CEO and Board to achieve and maintain a significant equity stake in Shutterfly and more closely align their interests with those of our stockholders. The current 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 are included for purposes of calculating ownership. The minimum level of ownership is expected to be achieved within five years of hire for the 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, 2017, 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 the NEOs, in the event of a substantial financial restatement resulting from the fraud or intentional misconduct of any executive officer.

This policy would enable the Committee to seek recoupment of the incremental portion of bonuses paid to 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 Act.

*Anti-Hedging Policy.* Under our stock ownership policy, our CEO and the 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 the 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.

## TAX CONSIDERATIONS

The accounting impact of our compensation programs and the tax deductibility of our compensation programs are each one of many factors that are considered in determining the size and structure of our programs, so that we can ensure that our compensation programs are reasonable and in the best interests of our stockholders. Section 162(m) of the Code generally disallows the deductibility by any publicly held corporation of individual compensation expenses in excess of $1 million paid to certain executive officers 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 certain of our executive officers 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. We believe that compensation expense incurred in respect of our stock options granted prior to November 2, 2017, will be deductible pursuant to this transition rule. However, 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 certain executive officers will not be deductible.

The Compensation and Leadership Development 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 executive officers will not be deductible under Section 162(m).

## RISK CONSIDERATIONS

Our Committee regularly considers potential risks when reviewing and approving our compensation programs, including our executive compensation program, and our Committee 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 potential risks while rewarding 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 for employees created incentives for employees to take excessive or unreasonable risks that could materially harm Shutterfly. The Committee believes that our compensation plans 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.

## NON-GAAP FINANCIAL MEASURE

Regulation G, conditions for use of Non-GAAP financial measures, and other Securities Exchange Commission regulations define and prescribe the conditions for use of certain Non-GAAP financial information. We closely monitor Adjusted EBITDA, which meets the definition of a Non-GAAP financial measure. We define "Adjusted EBITDA" as earnings before interest, taxes, depreciation, amortization, and stock-based compensation.

We have not reconciled our combined company non-GAAP Adjusted EBITDA target of $450 million for 2020 to comparable GAAP operating income at this stage of the process because it is unreasonably difficult to provide guidance for stock-based compensation expense, capitalization and amortization of internal-use software and charges related to the proposed acquisition, which are reconciling items between GAAP operating loss and non-GAAP Adjusted EBITDA. The factors that may impact our future stock-based compensation expense and capitalization and amortization of internal-use software 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 and our inability to project the cost or scope of internally-produced software and charges related to the proposed acquisition during this time period.

To supplement our consolidated financial statements presented on a GAAP basis, we believe that Non-GAAP measures, including Adjusted EBITDA, 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 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 income (loss) or net income (loss) per share determined in accordance with GAAP. Management strongly encourages stockholders to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

The following is a reconciliation of Adjusted EBITDA for the years ended December 31, 2017 and 2016 (in thousands):

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

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| **Net income (loss)** | **$ 30,085** | **$ 15,906** |
| Add back: | | |
| Interest expense | 27,836 | 23,023 |
| Interest and other income, net | (1,481) | (501) |
| Tax expense | 5,160 | 10,682 |
| Depreciation and amortization | 103,862 | 113,651 |
| Stock-based compensation expense | 43,573 | 45,692 |
| Capital lease termination | 8,098 | — |
| Restructuring | 16,966 | — |
| **Non-GAAP Adjusted EBITDA** | **$234,099** | **$208,453** |

# 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 Compensation and Leadership Development 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 Compensation and Leadership Development Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Proxy Statement.

**Compensation and Leadership Development Committee**
Elizabeth Sartain, Chair
Thomas D. Hughes
Michael P. Zeisser

# COMPENSATION TABLES

## SUMMARY COMPENSATION TABLE

The following table presents compensation information for each NEO for the year ended December 31, 2017, and, to the extent required by the Securities and Exchange Commission compensation disclosure rules, the years ended December 31, 2016 and 2015. 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 ($)(5) | ALL OTHER COMPENSATION | TOTAL ($) |
|---|---|---|---|---|---|---|---|---|
| Christopher North | 2017 | 700,000 | — | — | — | 856,800 | — | 1,556,800 |
| President and Chief | 2016 | 411,202 | 1,972,450 | 7,245,000 | 11,475,000 | — | 354,333(6) | 21,457,985 |
| Executive Officer | 2015 | — | — | — | — | — | — | — |
| Michael Pope | 2017 | 415,000 | — | 1,051,625 | 943,283 | 203,184 | — | 2,613,092 |
| Senior Vice President, | 2016 | 415,000 | — | — | — | 105,450 | — | 520,450 |
| Chief Financial Officer | 2015 | 75,551 | — | 5,651,875 | — | 46,800 | — | 5,774,226 |
| Michele Anderson | 2017 | 296,154 | — | 2,199,994 | 1,766,146 | 153,720 | — | 4,416,014 |
| Senior Vice President, | 2016 | — | — | — | — | — | — | — |
| Retail | 2015 | — | — | — | — | — | — | — |
| Scott Arnold | 2017 | 176,346 | — | 2,383,075 | 2,009,470 | 115,920 | — | 4,684,811 |
| Senior Vice President, | 2016 | — | — | — | — | — | — | — |
| Enterprise | 2015 | — | — | — | — | — | — | — |
| Satish Menon | 2017 | 375,000 | — | 1,297,750 | 762,652 | 183,600 | — | 2,619,002 |
| Senior Vice President, | 2016 | 374,180 | — | 1,899,993 | — | 85,350 | — | 2,359,523 |
| Chief Technical Officer | 2015 | 369,333 | — | 336,075 | — | 150,190 | — | 855,598 |

(1) The amount in this column reflects a pro-rated base salary for Mr. North in 2016 and his annual base salary in 2017; a pro-rated base salary for Mr. Pope in 2015 and his annual base salary in 2016 and 2017; a pro-rated base salary for Ms. Anderson and Mr. Arnold in 2017; and a pro-rated base salary for Mr. Menon in 2015 and 2016 and his annual base salary in 2017.

(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. Going forward, Mr. North has no guaranteed bonus payments.

(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 8 of the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017. 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 amount reported in this column represents the aggregate grant date fair value of stock options awarded to each NEO in 2016 and 2017. 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, 2017.

(5) The amounts reported in this column represent cash awards earned by each NEO under our 2015, 2016 and 2017 Quarterly Bonus Plans for executive staff. The 2017 Quarterly Bonus Plan is 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 which are included in the "All Other Compensation" column.

## GRANTS OF PLAN-BASED AWARDS

The following table provides information on incentive awards granted to each NEO during the year ended December 31, 2017.

| | | | ESTIMATED FUTURE PAYOUTS UNDER NON-EQUITY INCENTIVE PLAN AWARDS | | | ESTIMATED FUTURE PAYMENTS UNDER EQUITY INCENTIVE PLAN AWARDS | | | ALL OTHER STOCK AWARDS: NUMBER OF SHARES OF STOCK OR UNITS | GRANT DATE FAIR VALUE OF STOCK AND OPTIONS AWARDS |
|---|---|---|---|---|---|---|---|---|---|---|
| NAME | TYPE OF AWARD | GRANT DATE | MINIMUM ($) | TARGET ($) | MAXIMUM ($) | THRESHOLD (#) | TARGET (#) | MAXIMUM (#) | (#) | ($)(1) |
| Christopher North | Cash (2) | — | — | 700,000 | 1,400,000 | — | — | — | — | — |
| Michael Pope | Cash (2) | — | — | 166,000 | 332,000 | — | — | — | — | — |
| | RSU (3) | 2/14/2017 | — | — | — | — | — | — | 23,500 | 1,051,625 |
| | Option (4) | 2/14/2017 | — | — | — | — | — | — | 78,771 | 943,283 |
| Michele Anderson | Cash (2) | — | — | 105,000 | 210,000 | — | — | — | — | — |
| | RSU (3) | 2/27/2017 | — | — | — | — | — | — | 48,161 | 2,199,994 |
| | Option (4) | 2/27/2017 | — | — | — | — | — | — | 144,483 | 1,766,146 |
| Scott Arnold | Cash (2) | — | — | 70,000 | 140,000 | — | — | — | — | — |
| | RSU (3) | 6/30/2017 | — | — | — | — | — | — | 50,170 | 2,383,075 |
| | Option (4) | 6/30/2017 | — | — | — | — | — | — | 157,894 | 2,009,470 |
| Satish Menon | Cash (2) | — | — | 150,000 | 300,000 | — | — | — | — | — |
| | RSU (3) | 2/14/2017 | — | — | — | — | — | — | 19,000 | 850,250 |
| | RSU (3) | 2/14/2017 | — | — | — | — | — | — | 10,000 | 447,500 |
| | Option (4) | 2/14/2017 | — | — | — | — | — | — | 63,687 | 762,652 |

(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 8 of the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017. 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) The amounts reported represent possible aggregate annual cash awards payable to each NEO under our 2017 Quarterly Bonus Plan for executive staff. Each NEO could earn a range from 0% to 200% of the target award (but subject to the overall pool funding cap of 125% of target). Actual payouts under the 2017 Bonus Plan were approved by the Compensation and Leadership Development Committee on a quarterly basis based on our actual performance. The 2017 Quarterly Bonus Plan is described in greater detail in "Compensation Discussion and Analysis".

(3) The amounts reported represent RSUs subject to time-based vesting requirements granted under the 2015 Plan or pursuant to an inducement award agreement between the NEO and Shutterfly entered into during 2017.

(4) The amounts reported represent stock options subject to time-based vesting requirements granted under the 2015 Plan or pursuant to an inducement award agreement between the NEO and Shutterfly entered into during 2017.

The material terms of our 2017 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 2017, 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, 2017. 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 ($)(1) | EQUITY INCENTIVE PLAN AWARDS NUMBER OF UNEARNED SHARES OR OTHER RIGHTS THAT HAVE NOT VESTED (#) | EQUITY INCENTIVE PLAN AWARDS: MARKET OR PAYOUT VALUE OF UNEARNED SHARES, UNITS, OR OTHER RIGHTS THAT HAVE NOT VESTED ($) | NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS EXERCISABLE (#) | NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS UNEXERCISABLE (#) | OPTION EXERCISE PRICE ($) | OPTION EXPIRATION DATE |
|---|---|---|---|---|---|---|---|---|---|
| Christopher North | 5/31/2016 (2) | 110,000 | 5,472,500 | — | — | — | — | — | — |
| | 5/31/2016 (3) | — | — | — | — | 336,458 | 513,542 | 48.30 | 5/30/2023 |
| Michael Pope | 10/27/2015 (4) | 35,000 | 1,741,250 | — | — | — | — | — | — |
| | 10/27/2015 (4) | 35,000 | 1,741,250 | — | — | — | — | — | — |
| | 2/14/2017 (4) | 23,500 | 1,169,125 | — | — | — | — | — | — |
| | 2/14/2017 (3) | — | — | — | — | — | 78,771 | 44.75 | 2/13/2024 |
| Michele Anderson | 2/27/2017 (4) | 48,161 | 2,396,010 | — | — | — | — | — | — |
| | 2/27/2017 (3) | — | — | — | — | — | 144,483 | 45.68 | 2/26/2024 |
| Scott Arnold | 6/30/2017 (4) | 50,170 | 2,495,958 | — | — | — | — | — | — |
| | 6/30/2017 (3) | — | — | — | — | — | 157,894 | 47.50 | 6/30/2024 |
| Satish Menon | 11/3/2014 (4) | 12,500 | 621,875 | — | — | — | — | — | — |
| | 11/3/2014 (4) | 12,500 | 621,875 | — | — | — | — | — | — |
| | 2/10/2016 (4) | 18,642 | 927,440 | — | — | — | — | — | — |
| | 2/10/2016 (4) | 18,642 | 927,440 | — | — | — | — | — | — |
| | 2/14/2017 (4) | 19,000 | 945,250 | — | — | — | — | — | — |
| | 2/14/2017 (5) | 10,000 | 497,500 | — | — | — | — | — | — |
| | 2/14/2017 (3) | — | — | — | — | — | 63,687 | 44.75 | 2/13/2024 |

(1) Value is calculated by multiplying the number of RSUs that have not vested by the closing market price of our stock ($49.75) on December 29, 2017, the last trading day of 2017.

(2) The shares subject to this RSU will vested as follows: (i) 50,000 shares on May 31, 2018, and (ii) 60,000 shares on May 31, 2019, provided the NEO is still employed by us on each such vesting date.

(3) 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.

(4) 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.

(5) The shares subject to this RSU will 100% vest on February 14, 2019 provided the NEO is still employed by us on such vesting date.

## OPTION EXERCISES AND STOCK VESTED

The following table provides information regarding stock option exercises by our NEOs during the year ended December 31, 2017, and the number of shares issued to each NEO upon vesting of RSUs during 2017. No options were exercised by any of our NEOs during 2017. 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 | — | — | 40,000 | 1,979,600 |
| Michael Pope | — | — | 35,000 | 1,465,100 |
| Michele Anderson | — | — | — | — |
| Scott Arnold | — | — | — | — |
| Satish Menon | — | — | 37,428 | 1,587,832 |

## 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 median of the total compensation of our employees to be $77,446. The total 2017 compensation of Mr. North, as reported in the Summary Compensation Table above, was $1,556,800. Accordingly, the ratio of the 2017 annual total compensation of Mr. North to the median of the 2017 annual total compensation of our employees was approximately 20 to 1.

We identified the median of the total compensation of our employees by identifying the median employee, by 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.

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);
- Waiver of the obligation to repay any portion of (x) $1,000,000 of the transition bonus that remains subject to the repayment provision (as described above) if the termination occurs during the first year of employment or (y) $500,000 of the transition bonus that remains subject to the repayment provision (as described above) if the termination occurs during the second year of employment;
- 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 pursuant to the terms of his offer letter; and
- If the termination occurs after the first anniversary of his employment with Shutterfly, 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 occurs (x) after May 31, 2017, acceleration of the number of then-unvested shares subject to the "North Option" that would have vested during the next 12 months or (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.

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, 2017.

| | | | | 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 | $— | $ 700,000 | $ 700,000 | $ 700,000 | $ 700,000 |
| Bonus | — | — | — | — | — |
| Health Benefits (1) | — | 50,359 | 50,359 | 50,359 | 50,359 |
| Value of Accelerated Stock Options | — | 308,125 | 308,125 | 308,125 | 308,125 |
| Value of Accelerated Restricted Stock Units | — | 5,472,500 | 5,472,500 | 5,472,500 | 5,472,500 |

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

## Amended and Restated Executive Retention Agreements: Other NEOs

In February 2017, the Board approved management to negotiate and prepare new amended and restated retention agreements for our NEOs other than our current Chief Executive Officer (the "Amended Retention Agreements"), to provide him or her with certain severance benefits in the event that his or her employment is terminated under specified circumstances, as set forth in the Amended Retention Agreements. Additionally, each Amended Retention Agreement supersedes in full the terms and provisions of the offer letters, as amended, of the NEOs (other than our Chief Executive Officer) as it relates to certain terms and benefits resulting from a change in control of Shutterfly. The Amended Retention Agreements because effective (1) with respect to any CIC Qualifying Termination (as defined in the Amended Retention Agreement), the date in 2017 on which the NEO signed the Amended Retention Agreement and (b) with respect to any Qualifying Termination (as defined in the Amended Retention Agreement), January 1, 2018.

The Amended 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 Amended Retention Agreement) has been signed Shutterfly on or before the Expiration Date, then the Amended 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 Amended Retention Agreement following a termination of the NEO's employment with Shutterfly due to a Qualifying Termination or CIC Qualifying Termination.

The Amended 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 Amended Retention Agreement would otherwise renew.

### Termination Not in Connection with a Change in Control

If the NEO's service had been terminated by Shutterfly without cause or by the NEO for good reason prior to January 1, 2018 (other than within 12 months following a Change in Control (as defined in the Amended Retention Agreements)), the Company's original retention agreements for our NEOs (the "Retention Agreements") will govern. Pursuant to the terms of the Retention Agreement, the NEO is entitled to receive the following benefits, subject to a general release of claims:

- Lump sum cash payment equal to 12 months of the NEO's monthly base salary for the year during which the termination occurs; and
- Acceleration of that number of the NEO's Equity Awards (as defined in the Retention Agreement) that would have vested had the executive completed an additional 12 months of service, including any performance-based awards (subject to achievement 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 executive and his/her dependents for 12 months (or cash equivalent).

The Retention Agreements also provide for payment of any accrued but unpaid base salary and other vested but unpaid cash entitlements and any other vested benefits earned by the executive for the period through and including the termination date under any of our other benefit plans and arrangements.

If the NEO's service is terminated by Shutterfly without cause or by the NEO for good reason on or after January 1, 2018 (other than within 12 months following a Change in Control) and during the term of the Amended Retention Agreement, the Amended Retention Agreement will govern. Pursuant to the terms of the Amended Retention Agreement, the NEO is entitled to receive the following benefits, subject to a general release of claims:

- Lump sum cash severance payment equal to 6 months of the NEO's base salary for the year during which the termination occurs;
- Acceleration of that number of the NEO's Equity Awards (as defined in the Amended Retention Agreement) equal to a number of shares subject to each equity award calculated by multiplying 50% 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 achievement 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 6 months (or cash equivalent).

## Termination in Connection with a Change in Control

If within 12 months following the consummation of a Change in Control (as defined in the Amended Retention Agreement), the NEO's service is terminated by the Company or its successor without Cause (as defined in the Amended Retention Agreement) or by the NEO for Good Reason (as defined in the Retention Agreement), the NEO is 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 (as defined in the Amended Retention Agreement), including any performance-based awards (measured at 100% of target); 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 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, 2017. The table is pursuant to the terms set forth in Mr. Pope's offer letter, the Retention Agreement and the Amended and Restated 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 | $— | $ 415,000 | $ 415,000 | $ 415,000 | $ 415,000 |
| Bonus | — | — | — | — | — |
| Health Benefits (1) | — | 33,572 | 33,572 | 33,572 | 33,572 |
| Value of Accelerated Stock Options | — | 98,465 | 98,465 | 393,855 | 393,855 |
| Value of Accelerated Restricted Stock Units | — | 2,033,531 | 2,033,531 | 4,651,625 | 4,651,625 |

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

**Michele Anderson**. The following table summarizes the potential payments and benefits payable to Ms. Anderson 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. Anderson was terminated on December 31, 2017. The table is pursuant to the terms set forth in Ms. Anderson's offer letter, the Retention Agreement and the Amended and Restated 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 | $— | $350,000 | $350,000 | $ 350,000 | $ 350,000 |
| Bonus | — | — | — | — | — |
| Health Benefits (1) | — | 22,026 | 22,026 | 22,026 | 22,026 |
| Value of Accelerated Stock Options | — | 147,012 | 147,012 | 588,046 | 588,046 |
| Value of Accelerated Restricted Stock Units | — | 599,040 | 599,040 | 2,396,010 | 2,396,010 |

(1) This amount reflects our maximum 12 month obligation. If Ms. Anderson became covered by another employer's health plan during such 12 month period, then our obligation to pay Ms. Anderson's health plan coverage shall cease.

**Scott Arnold.** The following table summarizes the potential payments and benefits payable to Mr. Arnold 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. Arnold was terminated on December 31, 2017. The table is pursuant to the terms set forth in Mr. Arnold's offer letter, the Retention Agreement and the Amended and Restated 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 | $— | $350,000 | $350,000 | $ 350,000 | $ 350,000 |
| Bonus | — | — | — | — | — |
| Health Benefits (1) | — | 33,572 | 33,572 | 33,572 | 33,572 |
| Value of Accelerated Stock Options | — | 88,817 | 88,817 | 355,262 | 355,262 |
| Value of Accelerated Restricted Stock Units | — | 624,014 | 624,014 | 2,495,958 | 2,495,958 |

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

**Satish Menon.** The following table summarizes the potential payments and benefits payable to Mr. 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 Mr. Menon was terminated on December 31, 2017. The table is pursuant to the terms set forth in Mr. Menon's offer letter, the Retention Agreement and the Amended and Restated 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 | $— | $ 375,000 | $ 375,000 | $ 375,000 | $ 375,000 |
| Bonus | — | — | — | — | — |
| Health Benefits (1) | — | 33,572 | 33,572 | 33,572 | 33,572 |
| Value of Accelerated Stock Options | — | 79,610 | 79,610 | 318,435 | 318,435 |
| Value of Accelerated Restricted Stock Units | — | 2,098,356 | 2,098,356 | 4,541,379 | 4,541,379 |

(1) This amount reflects our maximum 12 month obligation. If Mr. Menon became covered by another employer's health plan during such 12 month period, then our obligation to pay Mr. 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 2017, except for Mr. North who did not receive any compensation for his service as a member of the Board. North's compensation is summarized in the "Compensation Discussion and Analysis" and "Compensation Tables" above.

| | YEAR ENDED DECEMBER 31, 2017 | | |
|---|---|---|---|
| **NAME** | **FEES EARNED OR PAID IN CASH** ($) | **STOCK AWARDS** ($)(1) | **TOTAL** ($) |
| Thomas D. Hughes | — | 199,994 | 199,994 |
| William J. Lansing (2) | 36,597 | 356,208 | 392,805 |
| Eva Manolis | — | 199,994 | 199,994 |
| Ann Mather | — | 199,994 | 199,994 |
| Elizabeth S. Rafael (3) | 15,000 | 234,968 | 249,968 |
| Elizabeth Sartain (4) | 10,000 | 219,994 | 229,994 |
| H. Tayloe Stansbury | — | 199,994 | 199,994 |
| Brian T. Swette (5) | 15,903 | 199,994 | 215,897 |
| Michael P. Zeisser | — | 199,994 | 199,994 |

(1) The amount in this column represents the aggregate grant date fair value of stock awards granted to each director during 2017 computed in accordance with Financial Accounting Standards Bulletin Accounting Standards Codification Topic 718. For more information regarding the assumptions used to calculate grant date fair value, see note 8 of our notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017. 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, 2017, 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 (5,375); Mr. Lansing (5,614); Ms. Manolis (3,940); Ms. Mather (5,375); Ms. Rafael (4,629); Ms. Sartain (4,334); Mr. Stansbury (3,940); Mr. Swette (5,375); Mr. Zeisser (5,375).

(2) Mr. Lansing was appointed to the Board in February 2017 and received a pro rata payment of $36,597 for his service as chairperson of the Board in 2017.

(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 a pro rata payment of $15,903 for his services as interim chairperson of the Board and chairperson of the Governance Committee.

Cash Compensation. Each of our independent 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 independent directors receives an annual restricted stock unit ("RSU") award worth $200,000 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 is entitled to an additional annual RSU award worth $85,000, the chair of the Audit Committee is entitled to an additional annual RSU award worth $35,000, and the chair of the Compensation and Leadership Development Committee is entitled to an additional restricted stock unit 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 annual 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 restricted stock awards will be prorated based on the term of service for that year.

Following the 2017 Annual Meeting held on May 24, 2017, we granted each independent director an annual RSU award for his or her service as a director of the Company valued at $200,000. In each such case, the RSU awards were valued based on the closing price of our Common Stock on May 24, 2017 of $50.76 and granted pursuant to the terms and conditions of our 2015 Plan. Consistent with our policy for partial year service, we also granted pro rata RSU awards to Mr. Lansing relating to his appointment to the Board in 2017.

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 900,000 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.

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 in April, 2017 and May 2017, respectively. The 2015 Plan includes features designed to address stockholder concerns related to equity incentive plans such as prohibiting repricing, eliminating "evergreen" share replenishment features, no single trigger vesting acceleration, and establishing an annual limit on non-employee director compensation.

The 2015 Plan is our only active employee equity plan. As of March 26, 2018, we anticipate that the 900,000 shares requested under the 2015 Plan Amendment, plus approximately 630,000 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 2019 Annual Meeting, accommodating anticipated grants relating to the hiring, retention and promotion of employees. The proposed increase represents approximately 2.7% of the total shares of common stock outstanding as of the record date.

Our Compensation and Leadership Development 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 Compensation and Leadership Development 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 and SVP of Retail over the last three years. We anticipate that our 2018 SVT will be 2.78% compared to an average of 4.69% over 2015-2017. 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 2017 AND EXPECTED 2017

### SHUTTERFLY STOCKHOLDER VALUE TRANSFER ("SVT")

| | ACTUAL | | | | PROJECTED |
|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 |
| (a) RSUs/PBRSUs Granted | 1,889,000 | 2,412,000 | 1,312,000 | 821,000 | 823,366 |
| (b) Stock Options Granted | — | — | 850,000 | 614,000 | 312,293 |
| (c) Option Black-Scholes % | — | — | 28.0% | 27.0% | 31.0% |
| (d) Avg. Common Shares Outstanding | 38,452,000 | 36,761,000 | 34,097,000 | 33,113,000 | 33,107,321 |
| (e) **SVT** **((a + b x c) ÷ d)** | **4.91%** | **6.56%** | **4.54%** | **2.98%** | **2.78%** |

## SHUTTERFLY SVT VS. PEERS

| 3-YEAR AVERAGE SVT | |
|---|---|
| Peer 75th Percentile | 4.79% |
| Peer Median | 3.21% |
| Peer 25th Percentile | 2.26% |
| Shutterfly (2015-2017) | 4.69% |
| Shutterfly Expected 2018 | 2.78% |

We also note that our active share repurchase program has elevated our "burn rate" percentage reported by proxy advisory groups in recent years. Over the course of fiscal 2016 and 2017, we have 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, these shares repurchases have returned value to our stockholders and have mitigated the dilutive effect of our equity grants. However, the repurchases have 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 outweigh any impact the lower number of shares outstanding may have on "burn rate" or similar calculations.

Our Board adopted the 2015 Plan Amendment on April 12, 2018, 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 13,310,777 shares (and will increase to 14,210,777 if the Plan Amendment is approved). No more than 2,700,000 shares may currently be issued pursuant to the exercise of incentive stock options; this number would increase to 3,600,000 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 26, 2018, approximately 1,000 employees and 9 non-employee directors will be eligible to participate in the 2015 Plan under our current participation guidelines. As of March 26, 2018, the closing price of our common stock was $83.25 per share.

Equitable Adjustments. As is typical in equity plans, the Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development 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, presuming our stockholders approve the 2015 Plan Amendment, 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.

Code Section 162(m). The 2015 Plan is intended to enable us to provide certain forms of performance-based compensation to certain of our executive officers that will meet the requirements for tax deductibility under Section 162(m).

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 Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development Committee's original intent regarding the performance factors at the time of the initial award grant. It is within the sole discretion of the Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development Committee and may be less than fair market value on the date of grant. Unless otherwise determined by the Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development 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 Compensation and Leadership Development 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 nonrestricted 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 Compensation and Leadership Development Committee. As discussed in "Director Compensation" above, each non-employee director of our Board is entitled to an annual restricted stock unit grant valued at $200,000 face value as determined by the closing price on the date of the Annual Meeting. The Chairman of the Board is entitled to 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 is entitled to 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 Compensation and Leadership Development Committee is entitled to 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, 2017.

| 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) | 2,582,794 | $10.48(3) | 1,765,468 |
| Equity Compensation Plans Not Approved by Stockholders (4) | 1,239,750 | 35.85(5) | — |
| **Total** | **3,822,544** | **—** | **1,765,468** |

(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.

(3) The weighted-average exercise price takes into account 1,978,034 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 $44.75.

(4) Includes 74,339 shares of our common stock subject to stock options outstanding under inducement stock option grant and 48,161 shares outstanding under inducement RSUs grant to Ms. Anderson in 2017; 850,000 shares of our common stock subject to stock options outstanding under inducement stock option grant and 110,000 shares outstanding under inducement RSUs grant to a Named Executive Officer (Mr. North) in 2016, 70,000 shares outstanding under inducement RSUs grants to a Named Executive Officer (Mr. Pope) in 2015; 43,500 shares outstanding under inducement RSUs grants to an executive officer (Ms.Layney) in 2015; 18,750 shares outstanding under inducement RSU grants to certain employees of an acquired company (Mobixon) received on the date of the acquisition in 2015; 25,000 shares outstanding under inducement RSUs grants to a Named Executive Officer (Mr. Menon) in 2014. 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 315,411 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 $48.09.

**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, 2018, 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 or not 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, 2017 and 2016. All fees described below were approved by the Audit Committee.

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| Audit Fees | $ 2,310,300 | $ 2,273,000 |
| Audit-Related Fees | — | — |
| Tax Fees | — | — |
| All Other Fees | 233,939 | 1,800 |
| **Total Fees** | **$2,544,239** | **$2,274,800** |

## AUDIT FEES

Audit fees of PricewaterhouseCoopers LLP during 2017 and 2016 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-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, 2017.**

# 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, 2017.

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, 2017 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, 2017 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, 2017 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 Compensation and Leadership Development 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 2017 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.

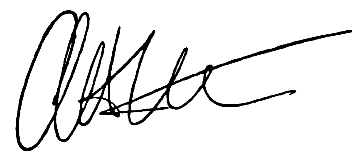
## ANNUAL REPORT

Our 2017 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 2017 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 2017 Annual Report contains our consolidated financial statements for fiscal 2017.

# ANNUAL REPORT ON FORM 10-K

We have filed our Annual Report on Form 10-K for fiscal 2017 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 http://ir.shutterfly.com/annual-reports-and-proxie. 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 2017, including the financial statements and financial statement schedules, but excluding exhibits to the Annual Report on Form 10-K for fiscal 2017. Exhibits to the Annual Report on Form 10-K for fiscal 2017 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 13, 2018

# APPENDIX A

## SHUTTERFLY, INC.
## 2015 EQUITY INCENTIVE PLAN

(adopted by the Board on November 17, 2015)
(amended and restated through April 12, 2018)

**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 3.600,000 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 3,600,000 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 provided that such adjustments are consistent with the regulations promulgated under Section 162(m) of the Code with respect to persons whose compensation is subject to Section 162(m) of the Code;

(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 Section 162(m) of the Code and Section 16 of the Exchange Act. When necessary or desirable for an Award to qualify as "performance-based compensation" under Section 162(m) of the Code, the Committee administering the Plan in accordance with the requirements of Rule 16b-3 and Section 162(m) of the Code shall consist of at least two individuals, each of whom qualifies as (a) a Non-Employee Director under Rule 16b-3, and (b) an "outside director" pursuant to Code Section 162(m) and the regulations issued thereunder. At least two (or a majority if more than two then serve on the Committee) such "outside directors" shall approve the grant of such Award and timely determine (as applicable) the Performance Period and any Performance Factors upon which vesting or settlement of any portion of such Award is to be subject. When required by Section 162(m) of the Code, prior to settlement of any such Award at least two (or a majority if more than two then serve on the Committee) such "outside directors" then serving on the Committee shall determine and certify in writing the extent to which such Performance Factors have been timely achieved and the extent to which the Shares subject to such Award have thereby been earned. Awards granted to Participants who are subject to Section 16 of the Exchange Act must be approved by two or more "non-employee directors" (as defined in the regulations promulgated under Section 16 of the Exchange Act). With respect to Participants whose compensation is subject to Section 162(m) of the Code, and provided that such adjustments are consistent with the regulations promulgated under Section 162(m) of the Code, the Committee may adjust the performance goals to account for changes in law and accounting and to make such adjustments as the Committee deems necessary or appropriate to reflect the impact of extraordinary or unusual items, events or circumstances to avoid windfalls or hardships, including without limitation (a) restructurings, discontinued operations, extraordinary items, and other unusual or non-recurring charges, (b) an event either not directly related to the operations of the Company or not within the reasonable control of the Company's management, or (c) a change in accounting standards required by generally accepted accounting principles.

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

**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).

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2017
ANNUAL
REPORT

INC

# 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, 2017**

**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**<br>**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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ☑ No ☐

Indicate by check mark 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. (check one)

| | |
|---|---|
| Large accelerated Filer ☑ | Accelerated Filer ☐ |
| Non-accelerated Filer ☐<br>(Do not check if a smaller reporting company) | Smaller reporting company ☐ |
| Emerging growth company ☐ | |

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

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

As of June 30, 2017, 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 30, 2017 as reported on The Nasdaq Global Select Market was $1,583,585,733.

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 13, 2018** |
|---|---|
| Common stock, $0.0001 par value per share | 32,516,924 |

**DOCUMENTS INCORPORATED BY REFERENCE**

Designated portions of the Proxy Statement relating to our 2018 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.

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## Part III



## Part IV

# 2017 ANNUAL REPORT

## Part I

Except for historical financial information contained herein, the matters discussed in this annual report on Form 10-K may be considered 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, and subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Such statements include declarations regarding our intent, belief, or current expectations and those of management. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks, uncertainties and other factors, some of which are beyond our control; actual results could differ materially from those indicated by such forward-looking statements. Important factors that could cause actual results to differ materially from those indicated by such forward-looking statements include, but are not limited to: (i) that the information is of a preliminary nature and may be subject to further adjustment; (ii) those risks and uncertainties identified in this annual report on Form 10-K under "Risk Factors;" and (iii) the other risks detailed from time-to-time in our reports and registration statements filed with the Securities and Exchange Commission, or SEC. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

### ITEM 1. BUSINESS.

#### Overview

Shutterfly, Inc. ("Shutterfly") 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.

We are the leading digital retailer and manufacturer of high-quality personalized products and services. Our purpose is to share life's joy by connecting people to what matters as the leading retailer and manufacturing platform for personalized products. We provide a full range of personalized photo-based products and services that make it easy, convenient and fun for consumers to upload, edit, enhance, organize, find, share, create, print, and preserve their memories in a creative and thoughtful manner.

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** leads the industry in personalized photo products and services. Shutterfly helps our customers turn their precious memories into lasting keepsakes with award-winning professionally-bound photo books, cards and stationery, custom home décor products and unique photo gifts 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 (celebrities and top designers alike) seek us out for our industry-leading designs and exceptional service.

**BorrowLenses** is the 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.

**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 revenues by marketing and manufacturing a variety of products such as cards and stationery, professionally-bound photo books, personalized gifts and home décor, calendars and high-quality prints. We manufacture many of these items in our Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona production facilities. 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 and can seamlessly manage demand across it. Some of the products that are currently manufactured for us by third parties include calendars, mugs, ornaments, candles, pillows and blankets.

Substantially all our revenue is generated from sales originating in the United States and our sales cycle has historically been highly seasonal as approximately 50% of our total net revenues occur during our fiscal fourth quarter. Further, our Tiny Prints boutique generates approximately 70% of its revenue in the fourth quarter. 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 customers are a central part of our business model. They generate most of the content on our service by uploading their photos and storing their memories. In addition, they share their photos electronically with their friends and families, extending and endorsing our brand and creating a sense of community. Finally, by giving our branded products to colleagues, friends and loved ones throughout the year, customers reinforce our brands. Through these various activities, our customers create a network of new users and customers.

In addition to driving lower customer acquisition costs through multiple marketing channels, our users provide input on new features, functionalities and products. Close, frequent customer interactions, coupled with significant investments in sophisticated integrated marketing programs, enable us to fine-tune and tailor our promotions and website presentation to specific customer segments. Consequently, customers are presented with a highly personalized shopping experience, which helps foster a unique and deep relationship with our brands.

To successfully execute our strategies, we require a talented leadership team. 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. By providing our employees with a great place to work, we believe that we continue to strengthen our high-performance culture.

On January 30, 2018, we entered into a Stock Purchase Agreement (the “Purchase Agreement”) with Lifetouch, Inc. (“Lifetouch”) and Lifetouch Inc. Employee Stock Ownership Trust (the “Seller”), pursuant to which we will acquire 100% of the issued and outstanding shares of common stock of Lifetouch from the Seller. The consummation of the acquisition is subject to customary closing conditions, including regulatory approval among other conditions. Under the terms of the Purchase Agreement, the consideration for the acquisition will consist of an all-cash purchase price of $825.0 million subject to certain post-closing adjustments based on a determination of closing net working capital, transaction expenses, cash and indebtedness. We expect to close the acquisition in the second quarter of 2018 and will finance the all-cash purchase price with an incremental $825.0 million term loan issuance. In connection with the Purchase Agreement, we entered into a commitment letter (the “Commitment Letter”), dated as of January 30, 2018, with Morgan Stanley Senior Funding, Inc. (“Morgan Stanley”), pursuant to which Morgan Stanley has committed to provide a secured incremental term loan facility in an aggregate amount of $825.0 million under our existing credit agreement. Issuance of the secured incremental term loan is subject to various conditions, including the execution of the definitive documentation and other customary closing conditions.

Lifetouch provides Shutterfly with a highly complementary business. We expect to gain access to many Lifetouch customers as Shutterfly customers, where they will benefit from Shutterfly’s leading cloud-photo management service, product creation capabilities, mobile apps, and broad product range. Lifetouch will be able to offer Shutterfly’s broader product range to Lifetouch customers, as well as to accelerate the development of Lifetouch’s online order-taking platform. We also expect to realize significant supply chain, manufacturing, and fulfillment synergies over time.

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 part of the plan, the following actions were taken:

- During the second quarter of 2017, we shut down the legacy Tiny Prints website and reinvested in Tiny Prints as our premium cards & stationery brand, creating a Tiny Prints boutique on a dedicated tab on Shutterfly.com;
- During the second quarter, the MyPublisher brand was retired in favor of the industry-leading Shutterfly Photo Books category; and
- During the third quarter of 2017, we launched the new Shutterfly Wedding Shop and shut down the Wedding Paper Divas legacy website. The Shutterfly Wedding Shop is a broad offering of personalized wedding products, including invitations, stationery, gifts, keepsakes and albums.

As of December 31, 2017, we substantially completed all actions under the 2017 Restructuring Plan. The Tiny Prints, MyPublisher and Wedding Paper Divas legacy websites were shut down during the first nine months of 2017. We planned to retain as many customers and as much revenue as possible while migrating customers from the legacy websites to Shutterfly.com and were successful in doing so. Further, as part of the plan, we announced that we would undertake a strategic review of BorrowLenses for possible sale. We 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 our restructuring expense line items within cost of net revenues and operating expenses in our consolidated statement of operations, as these were incurred during the twelve months ended December 31, 2017.

During the second quarter of 2017, we took advantage of an opportunity to complete the upgrade of the majority of our color printer fleet. The benefits of the upgrade include improved quality, increased throughput and automation, and lower consumable costs. We expect the new equipment to result in approximately $15.0 million in expense savings over the next five years. There are three pieces of this transaction as follows:

- Purchase of leased equipment from an existing vendor for $21.6 million;
- Sale of the purchased leased equipment to HP, Inc. ("HP") for $20.5 million; and
- Lease of new equipment from HP.

In the purchase of the existing leased equipment, the difference between the payment of $21.6 million and the fair value of the asset resulted in an $8.1 million capital lease termination charge (a separate line item in the consolidated statement of operations). The purchased equipment assets were recorded on the balance sheet at fair value of $12.9 million. The subsequent sale of the equipment to HP for $20.5 million resulted in the removal of the equipment assets and a capital lease incentive of $7.9 million to be amortized over the new lease term. Lastly, we leased new equipment from HP which upgraded most of our remaining color fleet to HP's high-end printers.

## Segment Information

Our reportable segments are Consumer, Shutterfly Business Solutions ("SBS").

### Consumer

Our Consumer revenues include sales from all our brands and are derived from the sale of a variety of products such as, professionally-bound photo books, cards and stationery, custom home décor products and unique photo gifts, calendars and prints, and related shipping revenues, as well as rental revenue from our BorrowLenses brand. Revenue from advertising displayed on our websites is also included in Consumer revenues. Consumer revenues as a percentage of total net revenues were 84% in 2017, 88% in 2016 and 91% in 2015.

### SBS

Our SBS revenues are primarily from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for our business customers. We target the financial, retail, technology and health care verticals primarily with our direct sales team. With the help of our leading manufacturing platform, we are building a scalable SBS platform that enables any of our clients to optimize their integrated marketing campaigns. We continue to focus our efforts in expanding our presence in these industries. SBS revenues as a percentage of total net revenues were 16% in 2017, 12% in 2016 and 9% in 2015.

In addition to the above reportable segments, we have a corporate category that includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation expense and amortization of intangible assets.

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 13-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."

## Business Initiatives

### Consumer

During the first quarter of 2017, we announced a restructuring of our Consumer business over the course of 2017, simplifying our brand portfolio, creating a Tiny Prints boutique on a dedicated tab on Shutterfly.com, and shutting down the legacy Tiny Prints, Wedding Paper Divas, and MyPublisher websites while encouraging those customers to migrate to Shutterfly.com. We anticipated that a transition of this magnitude would inevitably lead to the loss of some customers and revenues and sought to minimize the impact through investments in a simple migration process, in a great new home for Tiny Prints on Shutterfly.com, in further differentiating Tiny Prints as a premium brand, and in clear customer communications.

We completed all actions under the Restructuring Plan during 2017 and as a result, the Tiny Prints, MyPublisher and Wedding Paper Divas legacy websites were shut down during 2017. We were pleased to see that premium features of the Tiny Prints boutique resonated with customers, and encouraged that customers migrating from the legacy websites significantly increased their purchases of Shutterfly-brand products.

During 2017, we continued to make progress on our mobile app. We launched more than 40 new products in the app during 2017, while improving and simplifying in-app creation. We now have products from all our categories available in the app. We also improved and simplified the in-app creation experiences for Personalized Gifts, Home Décor, and Photo Books categories with more styles, designs, layouts and text options. In 2017, the percentage of revenues coming from mobile sources for the Shutterfly brand increased to 23% from 18% in 2016 and 13% in 2015. We continued to see a high install-to-first order ratio and attractive customer acquisition costs, with customers acquired via the mobile app having a superior return on investment ("ROI") versus customers acquired via desktop browser.

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. For example, the homepage of Shutterfly.com loaded twice as quickly this year as compared to the fourth quarter of 2017. Our manufacturing platform set new records for quality, delivery speed, and customer service, benefiting from the platform consolidation, process improvements, and equipment upgrades.

We continued to launch new physical products in 2017, including new products in the Personalized Gifts and Home Décor category, in addition to launching new products and designs in Photo Books, Cards and Stationery, and our Wedding category. Our Personalized Gifts and Home Décor category continued to gain traction with customers, growing at a double-digit rate year-over-year.

To support our business strategies within the Consumer segment, 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 ("SE"), 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.

Throughout 2017, we deployed dozens of highly integrated channel campaigns with a balance of direct response and brand awareness that enabled the company to reach new levels of brand awareness and engagement. During 2017, we entered into a philanthropic partnership with the Make-a-Wish Foundation. Further, our philanthropic partnership with The Ellen Show entered its sixth season in 2017 and we also launched new partnerships with other category leaders. Lastly, we continue to work closely with our key advertising partners to participate in new programs.

During 2017, we signed a multi-year deal with Amazon Web Services, Inc. ("AWS") to migrate our data to the cloud. This deal positions us to benefit from a cost-effective solution to scaling compared to the outlook from remaining in our own data center, enabling us to deliver innovative features and improve customer experience. Beyond anticipated cost savings, we expect to see benefits from higher developer productivity and speed of innovation.

### SBS

In 2017, SBS delivered strong performance through automation and more focused sales. We were successful in winning follow-on contracts from our existing key clients where our ability to execute on personalized print and digital communications at scale resulted in additional programs and volumes. As such, we signed a major multi-year deal with an existing technology client in 2017 and we continue to focus on obtaining additional new customers as well as deepening our existing relationships.

We believe customers are coming to SBS because we provide value at a level much above a traditional printer. We are an integrated marketing partner and with the help of our leading manufacturing platform, we are building a scalable SBS platform that enables any of our clients to optimize their integrated marketing campaigns. We believe our platform investments will further differentiate SBS and position us to capitalize on an important new industry opportunity.

## Strategy

Our vision is strongly motivated by the belief that sustainable growth comes from innovating on behalf of customers over the long term. We have four key areas of strategic focus:

- Make purchasing personalized products simple

  Our goal is to improve and over time radically simplify every aspect of the creation and purchase 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 plan to upgrade our entire 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.

- Offer customers a broader range of products

  Throughout Shutterfly's history, category expansion and new product launches have been one of the most reliable drivers of growth. We envision a future where we offer the broadest possible selection of premium, personalized products. In 2018, we will launch two new product categories, Kids and Pets, while continuing to launch additional product types in the Home Décor and Personalized Gifts categories. We also expect to reduce the cost and time to launch a new product to further accelerate the pace of product introduction in 2018 and beyond.

- Pivot towards mobile

  Mobile is a core element of our growth strategy itself and the above mentioned two areas of strategic focus also support our ambitious plans for mobile in 2018. 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.

- Leverage our manufacturing platform

  With SBS, 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. 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 2018, we expect to continue to deliver further improvements on quality, cost, automation, lower 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 our 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 average order sizes 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 automatically at checkout.

We are also able to dynamically assign visitors to test and control groups who are shown different versions of our service. 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 image archive as well as public clouds. Once a customer uploads a photo to our website, it is copied to highly redundant storage systems. We continue to expand our storage capacity to meet increasing customer demand. Our innovative storage architecture provides low storage costs, facilitates the safe, secure archiving of customers' images and delivers the speed and performance required to enable customers to access, enhance and edit 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. 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 image archive 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 had 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 this 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.

**Production system.**
We operate our own production facilities in Fort Mill, South Carolina; Tempe, Arizona; and Shakopee, Minnesota. Our automated production system controls our production processes, including order management and pick, pack and ship operations. Using proprietary algorithms, the production system analyzes tens of thousands 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 the smartest personalized e-commerce solutions with our 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.

Our technology and development expense was $168.4 million, $166.9 million, and $155.3 million in 2017, 2016 and 2015, respectively.

## 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, 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; and
- 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.

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. Generally, we distinguish ourselves from such competitors principally based on product quality and innovation, rather than price or same-day delivery.

## 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, 2017, we had 113 issued patents, which expire at various dates between 2019 and 2036, and more than 20 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” and “Tiny Prints”. We hold applications and/or registrations for the Shutterfly and Tiny Prints 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 mark in Mexico, Japan and China, and for the Shutterfly and Tiny Prints marks in Australia and New Zealand. We own the domains Shutterfly.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 that could have an impact on our business. These laws include the following:

- The CAN-SPAM Act of 2003 and similar laws adopted by a number of states. These laws are intended to regulate unsolicited commercial emails, create criminal penalties for unmarked sexually-oriented material and e-mails containing fraudulent headers and control other abusive online marketing practices.
- The Communications Decency Act, which gives statutory protection to online service providers who distribute third-party content.
- The Digital Millennium Copyright Act, 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.

- 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 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, 2017, we had 1,934 full time employees. Below is a summary of employees by function as of December 31, for each of the last three years:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Cost of revenue | 987 | 1,018 | 999 |
| Technology and development | 533 | 585 | 560 |
| Sales and marketing | 236 | 290 | 272 |
| General and administrative | 178 | 191 | 185 |
| **TOTAL** | **1,934** | **2,084** | **2,016** |

During the peak holiday season, we hire contract workers on a temporary basis from third-party outsourcing firms. For example, during our peak production period in the fourth quarter of 2017, we used approximately 4,000 temporary workers to assist in our 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 the Securities and Exchange Commission's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission also maintains an Internet website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the Securities and Exchange Commission. The Securities and Exchange Commission's Internet website is located at https://www.sec.gov.

# ITEM 1A. RISK FACTORS

## Risks Related to Our Business and Industry

### Our net revenues, 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 revenues, net income and operating cash flows generated during the fourth quarter. For example, we generated approximately 50% of our net revenues in the fourth quarter during each of the last three years. In addition, we incur significant additional expenses in the period leading up to the fourth quarter holiday season, 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. 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, 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 revenues 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. We may be unable to adjust spending quickly enough to offset any unexpected revenue shortfall. Accordingly, any shortfall in net revenues may cause significant variation in operating results in any quarter, particularly in the fourth quarter.

### If we are unable to meet our production requirements, our net revenues 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 revenues targets. Our capital expenditures were approximately 6%, 8% and 8% of total net revenues for the years ended December 31, 2017, 2016 and 2015, respectively. Operational difficulties, such as a significant interruption in the operations of our Fort Mill, South Carolina; Tempe, Arizona; or Shakopee, Minnesota 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 and damage our reputation and brands, which would result in reduced net revenues. 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 holiday seasons, and in particular during the fourth quarter, we face significant production risks, including the risk of obtaining sufficient qualified seasonal production personnel. A majority of our workforce during the fourth quarter of 2017 was seasonal, temporary personnel. We have had difficulties in the past finding and retaining a sufficient number of qualified seasonal employees, and our failure to find and retain qualified seasonal production personnel at any of our production facilities could harm our operations.

### Our business and stock price may be adversely affected if our planned acquisition of Lifetouch is not completed.

On January 30, 2018, we entered into an agreement to acquire Lifetouch; the transaction is subject to customary closing conditions (including regulatory approval) and is expected to close in the second quarter of 2018. We will finance the purchase price of the acquisition with an incremental $825.0 million term loan issuance. We entered into a commitment letter with Morgan Stanley Senior Funding, Inc. ("Morgan Stanley"), pursuant to which Morgan Stanley has committed to provide a secured incremental term loan facility in an aggregate amount of $825.0 million. Issuance of this term loan is subject to various conditions, including the execution of the definitive documentation and other customary closing conditions.

If we are unable finance the purchase price or the acquisition is otherwise not completed, our business might be adversely affected and the market price of our shares of common stock may decline to the extent the current market price of those shares reflects an assumption that the acquisition will be completed.

### The pending acquisition of Lifetouch may present many risks and we may not realize the financial and strategic goals that were contemplated at the time we entered into the purchase agreement.

Risks we may face in connection with the pending acquisition of Lifetouch include:

- We may not realize the benefits we expect to receive from the transaction, such as anticipated synergies and enhanced financial position;
- We may have difficulties (1) managing the acquired company's technologies and lines of business; (2) entering into a new business where we have no or limited direct prior experience; or (3) retaining key personnel from Lifetouch;
- 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 not 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) 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;
- Lifetouch is 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 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;
- We may fail to identify or assess the magnitude of certain liabilities, shortcomings or other circumstances 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;
- We may not realize the anticipated increase in our revenues from the Lifetouch; 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.

### 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 in the United States and their impact on levels of consumer spending, particularly spending on personalized products and photofinishing services. Consumer net revenue as a percentage of total net revenues was 84% in 2017, 88% in 2016 and 91% in 2015. 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 in a number of 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 ones 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 revenues and net income. From time to time, we have made changes to our pricing structure in order 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 revenues, 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 revenues and could adversely affect our gross margins and overall profitability.

We generate a significant portion of our net revenues 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 23% of our net revenues in 2017, 19% of our net revenues in 2016 and 20% in 2015. We 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 revenues 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. 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; and
- 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.

Many of our competitors 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 are able to 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 revenues 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 pricing and marketing strategies and those of our competitors;
- our ability to attract visitors to our websites and convert those visitors into customers;
- the potential impact of the current U.S. political climate on consumer spending;
- our ability to retain customers and encourage repeat purchases;
- the costs of customer acquisition;
- our ability to manage our production and fulfillment operations;
- the costs to produce our prints and photo-based products and merchandise and 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;
- our ability to achieve the expected benefits of strategic partnerships or the loss of any such partnership;
- declines or disruptions to the travel industry;
- variations in weather, particularly heavy rain and snow which tend to depress travel and picture taking;
- the timing of holidays and the duration of the holiday shopping season;
- general economic conditions, including recession and slow economic growth in the United States and worldwide and higher inflation;
- 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;
- consumer preferences for digital photography services;
- improvements to the quality, cost and convenience of desktop printing of digital pictures and products; 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.

### 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 revenues 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 revenues 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;
- maintain and enhance our brands;
- enhance and expand our products and services;
- continue to develop and upgrade our technology and information processing systems;
- 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.

### 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 revenues could adversely impact total net revenue.

SBS revenue as a percentage of total net revenues was 16% in 2017, 12% in 2016 and 9% in 2015. SBS gross margins were 20% in 2017, 26% in 2016 and 19% in 2015. 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 revenues. 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 have had in 2017, 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 revenues. 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 revenues 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. 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. If we are unable to keep the costs associated with operating our business aligned with the level of net revenues 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 revenues, costs and brand reputation.

As a part of our current 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 revenues, 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 revenues 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 website 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 revenues 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 revenues.

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 revenues 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. In the third quarter of 2017, Shutterfly added additional workloads to AWS thereby expanding the portions of our infrastructure 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 have required AWS software updates and patches to mitigate such vulnerabilities and such updates and patches required AWS servers to be offline and potentially slow 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 revenues 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 revenues 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 2014, unusually high seasonal traffic combined with system misconfigurations arising from our data center migration resulted in some days when customers could not place orders from our Tiny Prints brand. 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 revenues, 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 revenues we may lose.

### Any failure by us to protect the confidential information of our customers and 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. In addition to these threats, the security, integrity, and availability of our and our customers’ data could be compromised by employee negligence, error or malfeasance, and technology defects. Our failure to prevent security breaches could damage our reputation and brands and substantially harm our business and results of operations. For example, 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.

Our expanded use of cloud-based services (such as AWS) 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 is able to 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.

In addition, contractors we hire as well as other employees have access to confidential information, including credit card 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 produce many of our products or those that deliver our product 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. 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. Our failure to provide customers with high-quality products in a timely manner for any reason could substantially harm our reputation and our efforts to develop trusted brands, which would substantially harm our business and results of operations.

### 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 website is in Las Vegas, Nevada. We also have computer hardware located in our production facilities in Fort Mill, South Carolina; Shakopee, Minnesota; and Tempe, Arizona. 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.

## In order 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. And, 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. 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 in order 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.

## In order 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 are unable to acquire customers 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 in a cost-effective manner. 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. 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, 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.

### 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 revenues.

A component of our business strategy is the continued promotion and strengthening of the Shutterfly, 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 revenues. 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 professionally-bound photo books, cards and stationery, 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. 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.

### We currently outsource some of our off-line and online marketing, and some of our customer service activities to third parties, which exposes us to risks if these parties fail to perform under our agreements with them.

We currently outsource some of our off-line and online marketing, and some of our customer service activities to third parties. If these parties fail to perform in accordance with the terms of our agreements and if we are unable to secure another outsource partner in a timely manner, we would likely fail to meet customer expectations, which could result in negative publicity, damage our reputation and brands and harm our business and results of operations. In the fourth quarter of 2015, a third-party customer service provider experienced a disruption that affected our operations during peak times.

### We currently depend on third-party suppliers for our photographic print paper, printing machines and other supplies, which expose us to risks if these suppliers fail to perform under our agreements with them.

We purchase photo-based and other product supplies from third parties. These parties could increase their prices, reallocate supply to others, including our competitors, or choose to terminate their relationship with us. If one of these third parties chooses not to renew their agreements or fails to perform in accordance with the terms of their agreements and we are not able to secure supplies and services from a different source in a timely manner, we could fail to meet customer expectations, which could damage our reputation and harm our business. This competition may influence their willingness to provide us with additional products or services. If we were required to switch vendors of machines for photo-based or other products, we may incur delays and incremental costs, which could harm our operating results.

### 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. 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.

### 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, 2017, Shutterfly had 113 patents issued, and had more than 20 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," "Tiny Prints," "Wedding Paper Divas," and "BorrowLenses." We hold applications and/or registrations for the Shutterfly, 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 marks are critical components of our marketing programs. If we lose the ability to use these marks 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 marks that are similar to Shutterfly, Tiny Prints, Wedding Paper Divas, BorrowLenses, or one of our other marks.

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 marks 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 revenues and harm our results of operations and possibly prevent us from generating revenues 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 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 as a result of 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.

### Our practice of offering free products and services could be subject to judicial or regulatory challenge.

We regularly offer free products or free shipping as an inducement for customers to try our products. 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 the free product offer, we have been and in the future may be subject to claims from individuals or governmental regulators that our free 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, characterized by changing technologies, intense price competition, additional competitors, evolving industry standards, frequent new service and platform announcements and changing consumer demands and behaviors. To the extent that consumer adoption of digital photography does not continue to grow as expected, our revenue growth would likely suffer. 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, our current products and services may become less attractive, which would result in the loss of customers, as well as lower net revenues and/or increased expenses.

### Purchasers of digital photography products and services may not choose to shop or rent online, which would harm our net revenues 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. Our success 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 in order 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 revenues 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. 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 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.

### 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 as a result 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 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. We are currently assessing the impact of the TCJA on our business and consolidated financial statements.

### Uncertainties in the interpretation and application of the 2017 Tax Cuts and Jobs Act could materially affect our tax obligations and effective tax rate.

The TCJA was enacted on December 22, 2017, and significantly affected U.S. tax law by changing how the U.S. imposes income tax on multinational corporations. The U.S. Department of Treasury has broad authority to issue regulations and interpretative guidance that may significantly impact how we will apply the law and impact our results of operations in the period issued.

The TCJA requires complex computations not previously provided in U.S. tax law. As such, the application of accounting guidance for such items is currently uncertain. Further, 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 in order 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 revenues 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.

### 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:

- delays in, or an inability to consummate our planned acquisition of Lifetouch;
- failure to realize the anticipated benefits from the planned Lifetouch acquisition after it has closed;
- 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;
- 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 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, 2017, we have repurchased $533.2 million in stock under our total authorized amount of $646.0 million. The timing and actual number of shares repurchased will depend on a variety of factors including the timing of open trading windows, price, corporate and regulatory requirements, an assessment by management and our board of directors of cash availability and other market conditions. The stock repurchase program may be suspended or discontinued at any time without prior notice. In January 2018, we publicly announced that we suspended our stock repurchase program for an undetermined period of time as we are committed to de-levering. 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.

### Conversion of our 0.25% Convertible Senior Notes Due in May 2018 (the "Notes") may affect the price of our common stock.

The conversion of some or all of the Notes may dilute the ownership interest of existing shareholders to the extent we deliver shares of common stock upon conversion. Holders of the outstanding Notes will be able to convert them only upon the satisfaction of certain conditions, during the relevant observation period. Upon conversion, holders of the Notes will receive cash, shares of common stock or a combination of cash and shares of common stock. To the extent such sales are possible, any sales in the public market of shares of common stock issued upon conversion of such Notes could adversely affect the trading price of our common stock.

## Risks Related to Our 0.25% Senior Convertible Senior Notes Due in May 2018 (the "Notes")

### Although the Notes are referred to as convertible senior Notes, they are effectively subordinated to any of our secured debt and any liabilities of our subsidiaries.

The Notes will rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to any of our liabilities that are not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of our subsidiaries. In the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior in right of payment to the Notes will be available to pay obligations on the Notes only after the secured debt has been repaid in full from these assets, and the assets of our subsidiaries will be available to pay obligations on the Notes only after all claims senior to the Notes (including any amounts drawn under our credit facility) have been repaid in full. There may not be sufficient assets remaining to pay amounts due on any or all of the Notes then outstanding. The indenture governing the Notes does not prohibit us from incurring additional senior debt or secured debt, nor does it prohibit any of our subsidiaries from incurring additional liabilities.

### Recent and future regulatory actions and other events may adversely affect the trading price and liquidity of the Notes.

We expect that many investors in, and potential purchasers of, the Notes will employ, or seek to employ, a convertible arbitrage strategy with respect to the Notes. Investors would typically implement such a strategy by selling short the common stock underlying the Notes and dynamically adjusting their short position while continuing to hold the Notes. Investors may also implement this type of strategy by entering into swaps on our common stock in lieu of or in addition to short selling the common stock. The Securities and Exchange Commission ("SEC") and other regulatory and self-regulatory authorities have implemented various rules and taken certain actions, and may in the future adopt additional rules and take other actions, that may impact those engaging in short selling activity involving equity securities (including our common stock). Such rules and actions include Rule 201 of SEC Regulation SHO, the adoption by the Financial Industry Regulatory Authority, Inc. and the national securities exchanges of a "Limit Up-Limit Down" program, the imposition of market-wide circuit breakers that halt trading of securities for certain periods following specific market declines, and the implementation of certain regulatory reforms required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Any governmental or regulatory action that restricts the ability of investors in, or potential purchasers of, the Notes to effect short sales of our common stock or enter into swaps on our common stock could adversely affect the trading price and the liquidity of the Notes.

In addition, if investors and potential purchasers seeking to employ a convertible arbitrage strategy are unable to borrow or enter into swaps on our common stock, in each case on commercially reasonable terms, the trading price and liquidity of the Notes may be adversely affected.

### Volatility in the market price and trading volume of our common stock could adversely impact the trading price of the Notes.

The stock market in recent years has experienced significant price and volume fluctuations that have often been unrelated to the operating performance of companies. The market price of our common stock could fluctuate significantly for many reasons, including in response to the risks described in this section, or for reasons unrelated to our operations, such as reports by industry analysts, investor perceptions or negative announcements by our customers, competitors or suppliers regarding their own performance, as well as industry conditions and general financial, economic and political instability. A decrease in the market price of our common stock would likely adversely impact the trading price of the Notes. The price of our common stock could also be affected by possible sales of our common stock by investors who view the Notes as a more attractive means of equity participation in us and by hedging or arbitrage trading activity that we expect to develop involving our common stock. This trading activity could, in turn, affect the trading prices of the Notes.

### We may still incur substantially more debt or take other actions which would intensify the risks discussed above.

We and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our debt instruments, some of which may be secured debt. We will not be restricted under the terms of the indenture governing the Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the Notes that could have the effect of diminishing our ability to make payments on the Notes when due. Our existing credit facility restricts our ability to incur additional indebtedness, including secured indebtedness, but if the facility matures or is repaid, we may not be subject to such restrictions under the terms of any subsequent indebtedness.

### We may not have the ability to raise the funds necessary to settle conversions of our Notes in cash or to repurchase the Notes upon a fundamental change, and our current debt contains, and our future debt may contain, limitations on our ability to pay cash on conversion or repurchase the Notes.

Holders of the Notes have the right to require us to repurchase their Notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, if any. In addition, upon conversion of the Notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefor or Notes being converted.

In addition, our ability to repurchase the Notes and settle conversions in cash is limited by our credit facility and may be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to repurchase Notes at a time when the repurchase is required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under the credit facility agreements governing our future indebtedness. Moreover, the occurrence of a fundamental change under the indenture would constitute an event of default under our credit facility. If the payment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or to pay cash upon conversion of the Notes.

### The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the Notes is triggered, holders of Notes will be entitled to convert the Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation in cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

### The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, which we refer to as FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. We will report lower net income in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the Notes. In addition, under certain circumstances, convertible debt instruments (such as the Notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that any shares issuable upon conversion of the Notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the Notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Notes, then our diluted earnings per share would be adversely affected.

### Future sales of our common stock in the public market could lower the market price for our common stock and adversely impact the trading price of the Notes.

In the future, we may sell additional shares of our common stock to raise capital. In addition, a substantial number of shares of our common stock is reserved for issuance upon the exercise of stock options, the vesting of restricted stock units and other equity awards pursuant to our employee benefit plans, upon conversion of the Notes, and in relation to the convertible note hedge and warrant transactions entered into in connection with the pricing of the Notes. We cannot predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the trading price of the Notes and the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

### Holders of Notes will not be entitled to any rights with respect to our common stock, but they will be subject to all changes made with respect to them to the extent our conversion obligation includes shares of our common stock.

Holders of Notes will not be entitled to any rights with respect to our common stock (including, without limitation, voting rights and rights to receive any dividends or other distributions on our common stock) prior to the conversion date relating to such Notes (if we elect to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), but holders of Notes will be subject to all changes affecting our common stock. For example, if an amendment is proposed to our certificate of incorporation or bylaws requiring stockholder approval and the record date for determining the stockholders of record entitled to vote on the amendment occurs prior to the conversion date related to a holder's conversion of its Notes (if we have elected to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), such holder will not be entitled to vote on the amendment, although such holder will nevertheless be subject to any changes affecting our common stock.

### The conditional conversion feature of the Notes could result in holders receiving less than the value of our common stock into which the Notes would otherwise be convertible.

Holders of Notes may convert their Notes only if specified conditions are met. If the specific conditions for conversion are not met, holders will not be able to convert their Notes, and may not be able to receive the value of the cash, common stock or a combination of cash and common stock, as applicable, into which the Notes would otherwise be convertible.

### Upon conversion of the Notes, holders may receive less valuable consideration than expected because the value of our common stock may decline after holders exercise their conversion rights but before we settle our conversion obligation.

Under the Notes, a converting holder will be exposed to fluctuations in the value of our common stock during the period from the date such holder surrenders Notes for conversion until the date we settle our conversion obligation. Upon conversion of the Notes, we have the option to pay or deliver, as the case may be, cash, shares of our common stock, or a combination of cash and shares of our common stock. If we elect to satisfy our conversion obligation in cash or a combination of cash and shares of our common stock, the amount of consideration that holders will receive upon conversion of their Notes will be determined by reference to the volume weighted average prices of our common stock for each trading day in a 30 trading-day observation period. Accordingly, if the price of our common stock decreases during such observation period, the amount and/or value of consideration holders receive will be adversely affected. In addition, if the market price of our common stock at the end of such period is below the average of the volume weighted average price of our common stock during such period, the value of any shares of our common stock that holders will receive in satisfaction of our conversion obligation will be less than the value used to determine the number of shares that holders will receive.

If we elect to satisfy our conversion obligation solely in shares of our common stock upon conversion of the Notes, we will be required to deliver the shares of our common stock, together with cash for any fractional share, three business days after the relevant conversion date. Accordingly, if the price of our common stock decreases during this period, the value of the shares that holders receive will be adversely affected and would be less than the conversion value of the Notes on the conversion date.

### The Notes are not protected by restrictive covenants.

The indenture governing the Notes does not contain any financial or operating covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. The indenture contains no covenants or other provisions to afford protection to holders of the Notes in the event of a fundamental change or other corporate transaction involving us except under limited circumstances.

### The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change may not adequately compensate holders for any lost value of their Notes as a result of such transaction.

If a make-whole fundamental change occurs prior to the maturity date, under certain circumstances, we will increase the conversion rate by a number of additional shares of our common stock for Notes converted in connection with such make-whole fundamental change. The increase in the conversion rate will be determined based on the date on which the specified corporate transaction becomes effective and the price paid (or deemed to be paid) per share of our common stock in such transaction. The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change may not adequately compensate holders for any lost value of their Notes as a result of such transaction. Our obligation to increase the conversion rate for Notes converted in connection with a make-whole fundamental change could be considered a penalty, in which case the enforceability thereof would be subject to general principles of reasonableness and equitable remedies.

### The conversion rate of the Notes may not be adjusted for all dilutive events.

The conversion rate of the Notes is subject to adjustment for certain events, including, but not limited to, the issuance of certain stock dividends on our common stock, the issuance of certain rights or warrants, subdivisions, combinations, distributions of capital stock, indebtedness, or assets, cash dividends and certain issuer tender or exchange offers. However, the conversion rate will not be adjusted for other events, such as a third-party tender or exchange offer or an issuance of common stock for cash that may adversely affect the trading price of the Notes or our common stock. An event that adversely affects the value of the Notes may occur, and that event may not result in an adjustment to the conversion rate.

### Provisions in the indenture for the Notes may deter or prevent a business combination that may be favorable to holders of the Notes.

If a fundamental change occurs prior to the maturity date of the Notes, holders of the Notes will have the right, at their option, to require us to repurchase all or a portion of their Notes. In addition, if a make-whole fundamental change occurs prior to the maturity date of the Notes, we will in some cases be required to increase the conversion rate for a holder that elects to convert its Notes in connection with such fundamental change. Furthermore, the indenture for the Notes prohibits us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the Notes. These and other provisions in the indenture could deter or prevent a third party from acquiring us even when the acquisition may be favorable to holders of the Notes.

### Some significant restructuring transactions may not constitute a fundamental change, in which case we would not be obligated to offer to repurchase the Notes.

Upon the occurrence of a fundamental change, holders have the right to require us to repurchase their Notes. However, the fundamental change provisions will not afford protection to holders of Notes in the event of other transactions that could adversely affect the Notes. For example, transactions such as leveraged recapitalizations, refinancings, restructurings, or acquisitions initiated by us may not constitute a fundamental change requiring us to repurchase the Notes. In the event of any such transaction, the holders would not have the right to require us to repurchase the Notes, even though each of these transactions could increase the amount of our indebtedness, or otherwise adversely affect our capital structure or any credit ratings, thereby adversely affecting the holders of Notes.

### We have not registered the Notes or the common stock issuable upon conversion, if any, which will limit holders’ ability to resell them.

The Notes and the shares of common stock issuable upon conversion of the Notes, if any, have not been registered under the Securities Act of 1933, as amended, or the Securities Act, or any state securities laws. Unless the Notes and any shares of common stock issuable upon conversion of the Notes have been registered, they may not be transferred or resold except in a transaction exempt from or not subject to the registration requirements of the Securities Act and applicable state securities laws. We do not intend to file a registration statement for the resale of the Notes and the common stock, if any, into which the Notes are convertible.

### An active trading market may not develop for the Notes.

Prior to our issuance of the Notes, there had been no trading market for the Notes. We do not intend to apply to list the Notes on any securities exchange or to arrange for quotation on any automated dealer quotation system. The liquidity of the trading market in the Notes, and the market price quoted for the Notes, may be adversely affected by changes in the overall market for this type of security and by changes in our financial performance or prospects or in the prospects for companies in our industry generally. As a result, we cannot assure holders that an active trading market will develop for the Notes. If an active trading market does not develop or is not maintained, the market price and liquidity of the Notes may be adversely affected. In that case holders may not be able to sell their Notes at a particular time or holders may not be able to sell their Notes at a favorable price.

### Any adverse rating of the Notes may cause their trading price to fall.

We do not intend to seek a rating on the Notes. However, if a rating service were to rate the Notes and if such rating service were to lower its rating on the Notes below the rating initially assigned to the Notes or otherwise announces its intention to put the Notes on credit watch, the trading price of the Notes could decline.

### Holders of the Notes may be subject to tax if we make or fail to make certain adjustments to the conversion rate of the Notes even though such holders do not receive a corresponding cash distribution.

The conversion rate of the Notes will be adjusted in certain circumstances. Under Section 305(c) of the Code, adjustments (or failures to make adjustments) that have the effect of increasing the holders' proportionate interest in our assets or earnings may in some circumstances result in a deemed distribution to the holders. Certain of the conversion rate adjustments with respect to the Notes (including, without limitation, adjustments in respect of taxable dividends to holders of our common stock) will result in deemed distributions to the holders of Notes even though they have not received any cash or property as a result of such adjustments. In addition, an adjustment to the conversion rate in connection with a make-whole fundamental change may be treated as a deemed distribution. Any deemed distributions will be taxable as a dividend, return of capital, or capital gain. If holders are a "non-U.S. holder" under the Code any deemed dividend may be subject to U.S. withholding tax at a 30% rate or such lower rate as may be specified by an applicable tax treaty, which may be set off against subsequent payments on the Notes (or in certain circumstances, on the common stock). Under proposed regulations relating to certain "dividend equivalent" payments, an adjustment to the conversion rate of the Notes as a result of a dividend on our common stock may be subject to withholding tax at a different time or in a different amount than the withholding tax otherwise imposed on dividends and constructive dividends.

### The convertible note hedge and warrant transactions may affect the value of the Notes and our common stock.

In connection with the pricing of the Notes, we entered into convertible note hedge transactions with Morgan Stanley & Co. International plc, Credit Suisse International, Citibank, N.A., and Bank of America, N.A., or the option counterparties. We also entered into warrant transactions with the option counterparties pursuant to which we will sell warrants for the purchase of our common stock. The convertible note hedge transactions are expected generally to reduce the potential dilution upon any conversion of Notes and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of the Notes. The warrant transactions could separately have a dilutive effect to the extent that the market price per share of our common stock exceeds the strike price of the warrants. However, subject to certain conditions, we may elect to settle the warrant transactions in cash.

The option counterparties and/or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock in secondary market transactions following the pricing of the Notes and prior to the maturity of the Notes (and are likely to do so during any observation period related to a conversion of Notes or following any repurchase of Notes by us on any fundamental change repurchase date or otherwise). This activity could also cause or avoid an increase or a decrease in the market price of our common stock or the Notes, which could affect holders' ability to convert the Notes and, to the extent the activity occurs during any observation period related to a conversion of Notes, it could affect the amount and value of the consideration that holders will receive upon conversion of the Notes.

In addition, if any such convertible note hedge and warrant transactions fail to become effective, the option counterparties may unwind their hedge positions with respect to our common stock, which could adversely affect the value of our common stock and the value of the Notes. The potential effect, if any, of these transactions and activities on the market price of our common stock or the Notes will depend in part on market conditions and cannot be ascertained at this time. Any of these activities could adversely affect the value of our common stock and the value of the Notes (and as a result, the value of the consideration, the amount of cash and/or the number of shares, if any, that holders would receive upon the conversion of the Notes) and, under certain circumstances, holders' ability to convert the Notes. The convertible note hedge transactions and the warrant transactions are separate transactions (in each case entered into between us and the option counterparties), are not part of the terms of the Notes and will not affect the holders' rights under the Notes. Holders of the Notes will not have any rights with respect to the convertible note hedge transactions or the warrant transactions.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the Notes or our common stock. In addition, we do not make any representation that the option counterparties will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

**We are subject to counterparty risk with respect to the convertible note hedge transactions.** The option counterparties are financial institutions, and we will be subject to the risk that any or all of them might default under the convertible note hedge transactions. Our exposure to the credit risk of the option counterparties will not be secured by any collateral. Recent global economic conditions have resulted in the actual or perceived failure or financial difficulties of many financial institutions. If an option counterparty becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings, with a claim equal to our exposure at that time under our transactions with that option counterparty. Our exposure will depend on many factors but, generally, an increase in our exposure will be correlated to an increase in the market price and in the volatility of our common stock. In addition, upon a default by an option counterparty, we may suffer adverse tax consequences and more dilution than we currently anticipate with respect to our common stock. We can provide no assurances as to the financial stability or viability of the option counterparties.

## ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

## ITEM 2. PROPERTIES.

The table below includes material property leases, including both operating and build-to-suit leases.

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 | 300,000 | 2023 |
| Shakopee, Minnesota(2) | Manufacturing and customer service facility | 217,000 | 2024 |
| Tempe, Arizona(3) | Manufacturing and customer service facility | 237,000 | 2025 |

(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.

## 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. No material legal proceeding was terminated during the fourth quarter of 2017.

### The State of Delaware v. Shutterfly, Inc.

On May 1, 2014, the State of Delaware filed a complaint against us for alleged violations of the Delaware False Claims and Reporting Act, 6 Del C. § 1203(b)(2). The complaint asserts that we failed to report and remit to Delaware cash equal to the balances on unused gift cards under the Delaware Escheats Law, 12 Del. C. § 1101 et seq. We believe the suit is without merit.

### Monroy v. Shutterfly, Inc.

On November 30, 2016, Alejandro Monroy on behalf of himself and all others similarly situated, filed a complaint against us in the U.S. District Court for the Northern District of Illinois. The complaint asserts that we 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 that is currently in 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. We believe the suit is without merit and intend to vigorously defend against it.

In all cases, at each reporting period, we evaluate whether or not 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 and results of operations.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

## 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 13, 2018, there were approximately 70 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.

The following table sets forth the high and low closing sales price per share for Shutterfly's common stock for the periods indicated:

| YEAR ENDED DECEMBER 31, 2016 | HIGH | LOW |
|---|---|---|
| First Quarter | $47.13 | $37.41 |
| Second Quarter | $49.05 | $44.52 |
| Third Quarter | $53.19 | $44.11 |
| Fourth Quarter | $52.64 | $42.07 |

| YEAR ENDED DECEMBER 31, 2017 | HIGH | LOW |
|---|---|---|
| First Quarter | $53.49 | $42.91 |
| Second Quarter | $53.21 | $46.62 |
| Third Quarter | $50.55 | $44.40 |
| Fourth Quarter | $49.87 | $40.26 |

### Issuer Purchases of Equity Securities

The following table provides information about our repurchase of shares of our common stock during the fourth quarter of the fiscal year ended December 31, 2017:

| PERIOD(1) | TOTAL NUMBER OF SHARES PURCHASED | AVERAGE PRICE PAID PER SHARE | TOTAL NUMBER OF SHARES PURCHASED UNDER PUBLICLY ANNOUNCED PLANS OR PROGRAMS (2)(3)(4) | APPROXIMATE DOLLAR VALUE OF SHARES THAT MAY YET BE PURCHASED UNDER THE PLANS OR PROGRAMS (IN THOUSANDS)(2)(3)(4) |
|---|---|---|---|---|
| October 1, 2017 to October 31, 2017 | 560,062 | $ 45.97 | 560,062 | $ 117,039 |
| November 1, 2017 to November 30, 2017 | 100,403 | 42.35 | 100,403 | 112,787 |
| December 1, 2017 to December 31, 2017 | — | — | — | 112,787 |
| **TOTAL** | **660,465** | **$45.42** | **660,465** | **$112,787** |

(1) All shares were purchased pursuant to the publicly announced share repurchase program described in footnote 2 below. Shares are reported in a period based on the settlement date of the applicable repurchase.

(2) On November 1, 2012, we announced a share repurchase program authorized by our Board of Directors and approved by our Audit Committee to repurchase up to $60 million of our common stock. On February 6, 2014, our Board of Directors approved an increase to the share repurchase program to allow for repurchases of up to an additional $100 million of shares in addition to any amounts repurchased as of the approval date. On February 9, 2015, our Board of Directors approved an increase to the share repurchase program to allow for repurchases of up to an additional $300 million of shares in addition to any amounts repurchased as of the approval date. On April 21, 2016, our Board of Directors approved an increase of up to an addition $100 million of shares in addition to any amounts repurchased as of the approval date.

(3) On April 18, 2017, our Board of Directors approved an increase to repurchase up to $140.0 million in addition to amounts authorized to date. The share repurchase authorization, which became 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 share repurchase program is subject to prevailing market conditions and other considerations; does not require Shutterfly to repurchase any dollar amount or number of shares; and may be suspended or discontinued at any time.

(4) We suspended our share repurchase program as of December 31, 2017 and we have publicly committed to de-levering.

# ITEM 6. SELECTED FINANCIAL DATA.

*The consolidated statements of operations data for the years ended December 31, 2017, 2016 and 2015 and the consolidated balance sheet data as of December 31, 2017 and 2016 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 years ended December 31, 2014 and 2013 and the consolidated balance sheet data as of December 31, 2015, 2014 and 2013 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, | | | | |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands, except per share amounts) | | | | |
| **CONSOLIDATED OPERATIONS STATEMENT DATA:** | | | | | |
| Net revenues | $1,190,202 | $1,134,224 | $1,059,429 | $ 921,580 | $ 783,642 |
| Cost of net revenues | 619,650 | 566,117 | 528,078 | 452,720 | 369,593 |
| Restructuring | 1,475 | — | — | — | — |
| **GROSS PROFIT** | **569,077** | **568,107** | **531,351** | **468,860** | **414,049** |
| Operating expenses: | | | | | |
| Technology and development | 168,383 | 166,909 | 155,318 | 133,623 | 108,995 |
| Sales and marketing | 197,708 | 233,585 | 236,749 | 216,035 | 189,985 |
| General and administrative | 117,797 | 118,503 | 121,019 | 112,957 | 93,011 |
| Capital lease termination | 8,098 | — | — | — | — |
| Restructuring | 15,491 | — | — | — | — |
| **TOTAL OPERATING EXPENSES** | **507,477** | **518,997** | **513,086** | **462,615** | **391,991** |
| Income from operations | 61,600 | 49,110 | 18,265 | 6,245 | 22,058 |
| Interest expense | (27,836) | (23,023) | (20,998) | (16,732) | (9,446) |
| Interest and other income, net | 1,481 | 501 | 744 | 508 | 308 |
| **INCOME (LOSS) BEFORE INCOME TAXES** | **35,245** | **26,588** | **(1,989)** | **(9,979)** | **12,920** |
| (Provision for) benefit from income taxes | (5,160) | (10,682) | 1,146 | 2,119 | (3,635) |
| **NET INCOME (LOSS)** | **$ 30,085** | **$ 15,906** | **$ (843)** | **$ (7,860)** | **$ 9,285** |
| Net income (loss) per share: | | | | | |
| Basic | $ 0.91 | $ 0.47 | $ (0.02) | $ (0.20) | $ 0.25 |
| **DILUTED** | **$ 0.88** | **$ 0.45** | **$ (0.02)** | **$ (0.20)** | **$ 0.24** |
| Weighted average shares: | | | | | |
| Basic | 33,113 | 34,097 | 36,761 | 38,452 | 37,680 |
| Diluted | 34,106 | 35,190 | 36,761 | 38,452 | 39,493 |

The chart above includes the following stock-based compensation amounts:

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands) | | | | |
| Cost of net revenues | $ 4,339 | $ 4,579 | $ 4,134 | $ 3,657 | $ 2,485 |
| Technology and development | 9,778 | 8,550 | 10,840 | 9,236 | 9,477 |
| Sales and marketing | 12,229 | 15,445 | 21,512 | 22,670 | 19,774 |
| General and administration | 17,227 | 17,118 | 23,972 | 26,199 | 21,792 |
| Restructuring | 814 | — | — | — | — |

The chart below includes selected data from our balance sheets:

| | DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| | (in thousands) | | | | |
| **CONSOLIDATED BALANCE SHEET DATA:** | | | | | |
| Cash, cash equivalents, and investments | $ 677,157 | $ 330,055 | $ 340,786 | $ 475,337 | $ 499,084 |
| Property and equipment, net | 266,860 | 284,110 | 281,779 | 241,742 | 155,727 |
| Working capital | 230,210 | 212,188 | 200,505 | 350,925 | 412,159 |
| Total assets | 1,534,800 | 1,195,576 | 1,205,327 | 1,327,774 | 1,260,459 |
| Current portion of long-term debt | 297,054 | — | — | — | — |
| Long-term debt | 292,457 | 278,792 | 264,361 | 250,714 | 237,810 |
| Other long-term liabilities | 119,195 | 137,035 | 123,112 | 122,268 | 69,336 |
| Total stockholders' equity | 550,724 | 559,161 | 606,062 | 757,806 | 788,095 |

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

## CAUTIONARY NOTE REGARDING 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 2018, 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 revenues, our manufacturing capabilities, our new production facilities, effective tax rates, outstanding convertible senior notes, our expected acquisition of Lifetouch, Inc. and related statements regarding the consummation of the acquisition and 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 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; consumer acceptance of our products and services; our ability to develop additional adjacent lines of business; successfully acquire businesses, including Lifetouch, Inc., and technologies and to successfully integrate and operate these acquired businesses, personnel and technologies; unforeseen changes in expense levels; competition and the pricing strategies of our competitors, which could lead to pricing pressure; the anticipated benefits of expanding the portions of our public cloud infrastructure 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.

### Overview

We are the leading digital retailer and manufacturer of high-quality personalized products and services. Our purpose is to share life's joy by connecting people to what matters as the leading retailer and manufacturing platform for personalized products. We provide a full range of personalized photo-based products and services that make it easy, convenient and fun for consumers to upload, edit, enhance, organize, find, share, create, print, and preserve their memories in a creative and thoughtful manner.

Our SBS revenues are primarily from personalized direct marketing and other end-consumer communications as well as just-in-time, inventory-free printing for our business customers. We target the financial, retail, technology and health care verticals primarily with our direct sales team.

We generate substantially all our revenue from sales originating in the United States and our sales cycle has historically been highly seasonal with approximately 50% of our total net revenues during our fiscal fourth quarter. Further, our Tiny Prints boutique generates approximately 70% of its revenue in the fourth quarter. 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.

In 2017, we delivered record net revenues, which increased 5% year over year to approximately $1.2 billion. This increase was driven by a 41% increase in revenue from our SBS segment while revenue from our Consumer segment remained flat year over year. We achieved this growth while simultaneously focusing on long-term strategic priorities and investments in consumer facing programs and infrastructure projects that will provide future scale and scope efficiencies. These included the following:

- During the first quarter of fiscal 2017, we initiated a plan to simplify the Consumer business, re-focusing our resources on a small number of high-potential opportunities while reducing overhead costs and moving towards a single Consumer technical platform. As a result, we reinvested in Tiny Prints boutique as our premium cards and stationery brand, creating a Tiny Prints boutique on a dedicated tab on Shutterfly.com, the MyPublisher brand was retired in favor of the industry leading Shutterfly photobooks category, and we launched the new Shutterfly Wedding Shop and shut down the Wedding Paper Divas legacy website.
- We saw strong performance in Cards & Stationery and Personalized Gifts and Home Décor. In Cards & Stationery, several of the new features and formats we launched in 2017 resonated with customers this holiday season, including gatefold cards and custom envelopes on Shutterfly, and the premium card offerings on the Tiny Prints boutique. In Personalized Gifts and Home Décor, we added over 20 products during the year, and saw double-digit revenue growth both for the fourth quarter and for the full year.
- We continued to make improvements to our mobile app. We launched more than 40 new products in the app during 2017, while improving and simplifying in-app creation.
- Our manufacturing platform set new records for quality, delivery speed, and customer service, benefiting from the platform consolidation, process improvements, and equipment upgrades. We successfully completed the upgrade of the majority of our color-printer fleet to HP Indigo 12000 high-end fleet of printers.
- We signed a multi-year deal with Amazon Web Services, Inc. to migrate to the cloud. This deal positions us to benefit from cost-effective scaling.
- Shutterfly Business Solution, or SBS, continued to expand as a business in 2017, with strong growth, demonstrating our ability to open our manufacturing platform to a broader range of customer use-cases.

On January 30, 2018, we entered into a Stock Purchase Agreement (the “Purchase Agreement”) with Lifetouch, Inc. (“Lifetouch”) and Lifetouch Inc. Employee Stock Ownership Trust (the “Seller”), pursuant to which we will acquire 100% of the issued and outstanding shares of common stock of Lifetouch from the Seller. The consummation of the acquisition is subject to customary closing conditions, including regulatory approval among other conditions. Under the terms of the Purchase Agreement, the consideration for the acquisition will consist of an all-cash purchase price of $825.0 million subject to certain post-closing adjustments based on a determination of closing net working capital, transaction expenses, cash and indebtedness. We expect to close the acquisition in the second quarter of 2018 and will finance the all-cash purchase price with an incremental $825.0 million term loan issuance. In connection with the Purchase Agreement, we entered into a commitment letter (the “Commitment Letter”), dated as of January 30, 2018, with Morgan Stanley Senior Funding, Inc. (“Morgan Stanley”), pursuant to which Morgan Stanley has committed to provide a secured incremental term loan facility in an aggregate amount of $825.0 million under our existing credit agreement. Issuance of the secured incremental term loan is subject to various conditions, including the execution of the definitive documentation and other customary closing conditions.

Lifetouch provides Shutterfly with a highly complementary business. We expect to gain access to many Lifetouch customers as Shutterfly customers, where they will benefit from Shutterfly’s leading cloud-photo management service, product creation capabilities, mobile apps, and broad product range. Lifetouch will be able to offer Shutterfly’s broader product range to Lifetouch customers, as well as to accelerate the development of Lifetouch’s online order-taking platform. We also expect to realize significant supply chain, manufacturing, and fulfillment synergies over time.

## Basis of Presentation

Net Revenues. Our net revenues are comprised of sales generated from Consumer and SBS segments.

Consumer. Our Consumer revenues include sales from all our brands and are derived from the sale of a variety of products such as, professionally-bound photo books, cards and stationery, custom home décor products and unique photo gifts, calendars and prints, and the related shipping revenues as well as rental revenue from our BorrowLenses brand. Revenue from advertising displayed on our websites is also included in Consumer revenues.

SBS. Our SBS revenues are 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.

In addition to the two reportable segments, we also have a corporate category that includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation and amortization of intangible assets.

Our Consumer segment is subject to seasonal fluctuations. In particular, we generate a substantial portion of our revenues during the holiday season in the fourth quarter. We also typically experience increases in net revenues during other shopping-related seasonal events, such as Easter, Mother's Day, Father's Day and Halloween. We generally experience lower net revenues 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, order backlog is not material to our business.

To further understand net revenue trends in our 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 customers generally have increased on an annual basis for each year since inception.

Total Number of Orders. We closely monitor total number of orders as a leading indicator of net revenue trends. We recognize net revenues 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. Total number of orders generally have increased on an annual basis for each year since 2000.

Average Order Value. Average order value ("AOV") is Consumer net revenues 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 SBS segment revenues are 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 revenues and operating results.

Cost of Net Revenues. Our cost of net revenues is split between our Consumer and SBS segments and our Corporate category.

Consumer. Cost of net revenues for the 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 revenues 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 revenues also includes inventory markdowns that are part of restructuring activities.

SBS. Cost of net revenues 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.

Corporate. Our corporate category includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation expense and amortization of intangible assets.

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 such as our ERP, 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. Our marketing efforts consist of various online and offline media programs, such as e-mail and direct mail promotions, 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, interest on our term loan issued in October 2017, costs associated with our syndicated credit facilities, and costs associated with our capital leases and build-to-suit lease 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 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 recognize revenue from Consumer and SBS product sales, net of applicable sales tax, upon shipment of fulfilled orders, when persuasive evidence of an arrangement exists, the selling price is fixed or determinable and collection of resulting receivables is reasonably assured. Customers place Consumer product orders through our websites or mobile apps and pay primarily using credit cards. SBS customers are invoiced upon fulfillment. Shipping charged to customers is recognized as revenue at the time of shipment and the related shipping costs are recognized as cost of net revenues.

For gift card sales and flash deal promotions through group-buying websites, we recognize revenue on a gross basis, as we are the primary obligor, when redeemed items are shipped. Revenues from sales of prepaid orders on our websites are deferred until shipment of fulfilled orders or until unredeemed prepaid orders are recognized as breakage revenue. Unredeemed prepaid orders are recognized as breakage revenue based on historical redemption patterns and represent orders for which we believe customer redemption is remote and it is not probable that we have an obligation to escheat the value of the prepaid order under unclaimed property laws.

In the second quarter of 2015, we changed our accounting estimate related to flash deal deferred revenue. Beginning in 2010, we began to market product offers on flash deal websites such as Groupon and LivingSocial. With limited history as to customer redemption patterns, we had been deferring all amounts to our flash deal deferred revenue liability until customer redemption. We now have sufficient relevant historical flash deal redemption data to support a change in estimate of the flash deal deferred revenue based on historical customer redemption patterns. The historical data supports the probability of redemption after two years from the issuance of a flash deal offer as remote. Accordingly, flash deal breakage revenue is recognized based upon our historical redemption patterns and represents the unredeemed flash deal offers for which we believe customer redemption is remote and it is not probable that we have an obligation to escheat the value of the flash deal revenue under unclaimed property laws. In the year ended December 31, 2017, 2016 and 2015, we recognized flash deal breakage revenue of $1.4 million, $5.3 million and $10.0 million, respectively.

We provide our customers with a return policy whereby products can be returned during a reasonable period of time for a reprint or refund. We maintain an allowance for estimated future returns based on historical data. The provision for estimated returns is included in accrued expenses. During the year ended December 31, 2017, returns totaled 1% of net revenues and have been within management's expectations.

We periodically provide incentive offers to our customers in exchange for setting up an account and to encourage purchases. Such offers include free products and percentage discounts on current purchases. Discounts, when accepted by customers, are treated as a reduction to the purchase price of the related transaction and are presented in net revenues. Production costs related to free products are included in cost of revenues upon redemption.

Our advertising revenues are derived from the sale of online advertisements on our websites. Advertising revenues are recognized as "impressions" (i.e., the number of times that an advertisement appears in pages viewed by users of our websites) are delivered; as "clicks" (which are generated each time users of our websites click through the advertisements to an advertiser's designated website) are provided to advertisers; or ratably over the term of the agreement with the expectation that the advertisement will be delivered ratably over the contract period.

Certain SBS revenue arrangements with multiple deliverables, including products and services, are divided into separate units and revenue is allocated using estimated selling prices if we do not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables. We allocate the arrangement price to each of the elements based on the relative selling prices of each element. Estimated selling prices are management's best estimates of the prices that we would charge our customers if we were to sell the standalone elements separately and include considerations of customer demand, prices charged by us and others for similar deliverables, and the price if largely based on the cost of producing the product or service. For up-front fees we received in exchange for products delivered or services performed, it is deferred and recognized over periods that the fees are earned. In cases in which an up-front fee is not related to specific products or services, the fee is excluded from the consideration that is allocated to the deliverables, and is recognized over the longer of the initial contractual term of the arrangement or the estimated period the customer is expected to benefit from the payment of the up-front fee.

For camera, lenses, and video equipment rentals from our BorrowLenses brand, we recognize rental revenue and the related shipping revenue, ratably over the rental period. Revenue from the sale of rental equipment is recognized upon shipment of the equipment.

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 one to sixteen years, and the amortization is allocated between cost of net revenues 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 two 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 unit 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 revenues 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 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 2017, our valuation allowance against certain California, South Carolina, and Arizona deferred tax assets increased to $17.1 million from $10.0 million in 2016. 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, 2017. 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, 2017. 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.

On December 22, 2017, H.R.1 "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal year 2018" commonly referred to as the Tax Cuts and Jobs Act (the "Act" or "Tax Reform") was signed by the President of the United States and became enacted law. The Tax Reform is complex and includes various changes which will impact us. We performed a preliminary assessment of the Tax Reform impacts and recorded an $8.9 million non-cash benefit due to the revaluation of our federal deferred tax liabilities in the fourth quarter of 2017, as a result of the reduction in the U.S. federal statutory tax rate from 35% to 21%.

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 awards ("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 awards ("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 is recognized on an accelerated attribution model. As of December 31, 2017, the PBRSUs are only subject to service vesting conditions as the performance criteria has been met.

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 revenues:

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Net revenues | 100% | 100% | 100% |
| Cost of net revenues | 52 | 50 | 50 |
| **GROSS PROFIT** | **48** | **50** | **50** |
| Operating expenses: | | | |
| Technology and development | 14 | 15 | 15 |
| Sales and marketing | 17 | 21 | 22 |
| General and administrative | 10 | 10 | 11 |
| Capital lease termination | 1 | — | — |
| Restructuring | 1 | — | — |
| **TOTAL OPERATING EXPENSES** | **43** | **46** | **48** |
| Income from operations | 5 | 4 | 2 |
| Interest expense | (2) | (2) | (2) |
| Interest and other income, net | — | — | — |
| **INCOME (LOSS) BEFORE INCOME TAXES** | **3** | **2** | **—** |
| (Provision for) benefit from income taxes | — | (1) | — |
| **NET INCOME (LOSS)** | **3%** | **1%** | **—%** |

## Comparison of the Years Ended December 31, 2017 and 2016

| | YEAR ENDED DECEMBER 31, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | $ CHANGE | % CHANGE |
| | (dollars in thousands) | | | |
| **CONSOLIDATED** | | | | |
| Net revenues | $1,190,202 | $1,134,224 | $55,978 | 5% |
| Cost of net revenues | 619,650 | 566,117 | 53,533 | 9% |
| Restructuring | 1,475 | — | 1,475 | 100% |
| **GROSS PROFIT** | **$ 569,077** | **$ 568,107** | **$ 970** | **—%** |
| *Gross profit as a percentage of net revenues* | *48%* | *50%* | | |

Net revenues increased $56.0 million, or 5%, in 2017 compared to 2016. Revenue growth was attributable to an increase in revenue from the SBS segment while revenue from the Consumer segment remained flat year over year. Cost of net revenues increased $53.5 million, or 9%, in 2017 compared to 2016. As a percentage of net revenues, cost of net revenues was 52% in 2017 compared to 50% in 2016. Also impacting gross profit in 2017 was $1.5 million of restructuring charges related to inventory markdowns. Gross margin decreased to 48% in 2017 from 50% in 2016 due to greater SBS segment mix and lower gross margins in the SBS segment.

## Consumer Segment

| | YEAR ENDED DECEMBER 31, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | $ CHANGE | % CHANGE |
| | (dollars in thousands) | | | |
| **CONSUMER** | | | | |
| Net revenues | $ 996,963 | $ 997,556 | $ (593) | — % |
| Cost of net revenues | 456,665 | 455,387 | 1,278 | — % |
| Restructuring | 1,475 | — | 1,475 | 100 % |
| **GROSS PROFIT** | **$538,823** | **$542,169** | **$(3,346)** | **(1)%** |
| *Gross profit as a percentage of net revenues* | *54%* | *54%* | | |

| | YEAR ENDED DECEMBER 31, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | $ CHANGE | % CHANGE |
| | (dollars 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 % |

Consumer net revenues 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 Consumer revenues represented 84% of total net revenues 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 Tiny Prints boutique revenue, as well as higher year-over-year purchases of Shutterfly-brand products by customers migrating from our legacy websites. Excluding the Tiny Prints 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 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.

Consumer cost of net revenues increased $1.3 million in 2017 compared to 2016. 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 Consumer segment. These restructuring charges were related to the obsolete inventory markdowns as part of the Consumer segment restructuring.

## *SBS Segment*

| | YEAR ENDED DECEMBER 31, | | | |
|---|---|---|---|---|
| | 2017 | 2016 | $ CHANGE | % CHANGE |
| | (dollars in thousands) | | | |
| **SHUTTERFLY BUSINESS SOLUTIONS (SBS)** | | | | |
| Net revenues | $193,239 | $136,668 | $ 56,571 | 41% |
| Cost of net revenues | 154,068 | 100,582 | 53,486 | 53% |
| **GROSS PROFIT** | **$ 39,171** | **$ 36,086** | **$ 3,085** | **9%** |
| *Gross profit as a percentage of net revenues* | *20%* | *26%* | | |

SBS net revenues increased $56.6 million, or 41%, in 2017 compared to 2016, and represented 16% of total net revenues in 2017. The increase in SBS net revenues 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 revenues increased $53.5 million, or 53%, in 2017 compared to 2016. SBS gross margin decreased to 20% in 2017 from 26% in 2016. The decrease in SBS gross margin is primarily due to increased costs associated with expansion of projects with our existing clients. The decrease in SBS gross margin is further impacted by lower gross margin on a major new deal we signed with an existing technology client which has 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.

## *Corporate Segment*

| | YEAR ENDED DECEMBER 31, 2017 | 2016 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| **CORPORATE** | | | | |
| Net revenues | $ — | $ — | $ — | — % |
| Cost of net revenues | 8,917 | 10,148 | (1,231) | (12)% |
| **GROSS PROFIT** | **$(8,917)** | **$(10,148)** | **$ 1,231** | **(12)%** |

Corporate cost of net revenues decreased $1.2 million, or 12% in 2017 compared to 2016, with the decrease being primarily a result of a decrease in amortization of intangible assets as certain of our intangible assets became fully amortized.

| | YEAR ENDED DECEMBER 31, 2017 | 2016 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| Technology and development | $168,383 | $166,909 | $ 1,474 | 1 % |
| *Percentage of net revenues* | *14%* | *15%* | | |
| Sales and marketing | $197,708 | $233,585 | $(35,877) | (15)% |
| *Percentage of net revenues* | *17%* | *21%* | | |
| General and administrative | $117,797 | $118,503 | $ (706) | (1)% |
| *Percentage of net revenues* | *10%* | *10%* | | |
| Capital lease termination | $ 8,098 | $ — | $ 8,098 | 100 % |
| *Percentage of net revenues* | *1%* | *—%* | | |
| Restructuring | $ 15,491 | $ — | $ 15,491 | 100 % |
| *Percentage of net revenues* | *1%* | *—%* | | |

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 consumer platform consolidation and our SBS Business. As a percentage of net revenues, technology and development expense decreased to 14% in 2017 from 15% in 2016. The overall increase in expense was primarily due to an increase of $5.4 million in professional fees, and an increase of $2.1 million in facilities costs primarily resulting from systems and database support and maintenance. There was also an increase of $2.1 million in personnel and related costs primarily due to bonuses, and an increase of $1.2 million in stock-based compensation expense. These factors were partially offset by an increase of $5.3 million in software and website development costs capitalized, and a decrease of $4.1 million in depreciation expense.

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. In 2017, we capitalized $33.1 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 $27.9 million, which included $1.4 million of stock-based compensation capitalized in 2016.

Our sales and marketing expense decreased $35.9 million, or 15%, in 2017 compared to 2016. As a percentage of net revenues, total sales and marketing expense decreased to 17% in 2017 from 21% in 2016. The decrease in sales and marketing expense 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, a decrease of $4.3 million in depreciation and amortization expense, and a decrease $3.2 million in stock-based compensation expense. 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.

Our general and administrative expense decreased $0.7 million, or 1%, in 2017 compared to 2016. As a percentage of net revenues, 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.

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.

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.

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | CHANGE |
| | (in thousands) | | |
| Interest expense | $(27,836) | $(23,023) | $(4,813) |
| Interest and other income, net | 1,481 | 501 | 980 |

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.

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (dollars in thousands) | |
| Income tax expense | $(5,160) | $(10,682) |
| Effective tax rate | 15% | 40% |

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.

## Comparison of the Years Ended December 31, 2016 and 2015

| | YEAR ENDED DECEMBER 31, 2016 | 2015 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| **CONSOLIDATED** | | | | |
| Net revenues | $1,134,224 | $1,059,429 | $ 74,795 | 7% |
| Cost of net revenues | 566,117 | 528,078 | 38,039 | 7% |
| **GROSS PROFIT** | **$ 568,107** | **$ 531,351** | **$36,756** | **7%** |
| *Gross profit as a percentage of net revenues* | *50%* | *50%* | | |

Net revenues increased $74.8 million, or 7%, in 2016 compared to 2015. Revenue growth was attributable to increases in revenue from both reportable segments. Cost of net revenues increased $38.0 million, or 7%, in 2016 compared to 2015. As a percentage of net revenues, cost of net revenues remained flat at 50% in 2016 and 2015. Gross margin also remained flat at 50% in both 2016 and 2015.

### *Consumer Segment*

| | YEAR ENDED DECEMBER 31, 2016 | 2015 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| **CONSUMER** | | | | |
| Net revenues | $ 997,556 | $ 961,418 | $ 36,138 | 4% |
| Cost of net revenues | 455,387 | 436,050 | 19,337 | 4% |
| **GROSS PROFIT** | **$542,169** | **$525,368** | **$16,801** | **3%** |
| *Gross profit as a percentage of net revenues* | *54%* | *55%* | | |

| | YEAR ENDED DECEMBER 31, 2016 | 2015 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (dollars in thousands, except AOV amounts) | | | |
| **KEY CONSUMER METRICS** | | | | |
| Total Customers | 10,116 | 9,751 | 365 | 4 % |
| Total Number of Orders | 27,109 | 25,806 | 1,303 | 5 % |
| Average order value (AOV) | $ 36.80 | $ 37.26 | $ (0.46) | (1)% |

Consumer net revenues increased $36.1 million, or 4%, in 2016 compared to 2015, and represented 88% of total net revenues in 2016. The increase in Consumer net revenues is primarily the result of increased mobile revenue and photo gifts. The increase is also reflected in the increases in customers and orders in 2016 as compared to 2015, as noted in the above table. Average order value decreased slightly in 2016 as compared to 2015 driven by product mix, promotion and increasing mobile revenue, which carries a lower average order value than our website.

Consumer cost of net revenues increased $19.3 million in 2016 compared to 2015. Overall, the increase in cost of net revenues was primarily driven by the increase in volume of shipped products as well as increased depreciation and headcount from our expanded manufacturing facilities.

## SBS Segment

| | YEAR ENDED DECEMBER 31, 2016 | 2015 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| **SHUTTERFLY BUSINESS SOLUTIONS (SBS)** | | | | |
| Net revenues | $136,668 | $ 98,011 | $ 38,657 | 39% |
| Cost of net revenues | 100,582 | 79,789 | 20,793 | 26% |
| **GROSS PROFIT** | **$ 36,086** | **$18,222** | **$17,864** | **98%** |
| *Gross profit as a percentage of net revenues* | *26%* | *19%* | | |

SBS net revenues increased $38.7 million, or 39%, in 2016 compared to 2015, and represented 12% of total net revenues in 2016. The increase was primarily due to the expansion of projects, higher revenue volumes with existing customers, and our ability to execute on personalized print and digital communications at scale resulted in additional programs and volumes.

SBS cost of net revenues increased $20.8 million in 2016 compared to 2015. SBS gross margin increased to 26% in 2016 from 19% in 2015. The increase in SBS gross margin is primarily due to improved customer targeting and favorable product mix as a result of expansion of projects with our existing customers.

## Corporate Segment

| | YEAR ENDED DECEMBER 31, 2016 | 2015 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (in thousands) | | | |
| **CORPORATE** | | | | |
| Net revenues | $ — | $ — | $ — | — % |
| Cost of net revenues | 10,148 | 12,239 | (2,091) | (17)% |
| **GROSS PROFIT** | **$(10,148)** | **$(12,239)** | **$2,091** | **(17)%** |

Corporate cost of net revenues decreased $2.1 million, or 17% in the year ended December 31, 2016 compared to the same period in 2015. The decrease in corporate cost of net revenues was primarily a result of fully amortized intangible assets relating to our business acquisitions in prior years.

| | YEAR ENDED DECEMBER 31, 2016 | 2015 | $ CHANGE | % CHANGE |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| Technology and development | $166,909 | $155,318 | $11,591 | 7 % |
| *Percentage of net revenues* | *15%* | *15%* | | |
| Sales and marketing | $233,585 | $236,749 | $ (3,164) | (1)% |
| *Percentage of net revenues* | *21%* | *22%* | | |
| General and administrative | $118,503 | $121,019 | $ (2,516) | (2)% |
| *Percentage of net revenues* | *10%* | *11%* | | |

Our technology and development expense increased $11.6 million, or 7%, in 2016, compared to 2015. As a percentage of net revenues, technology and development expense remained flat at 15% in 2016 and 2015. The increase in technology and development expense was primarily due to an increase of $6.6 million in personnel and related costs, reflecting additional hires during 2016. There was also an increase of $8.8 million in professional fees and an increase of $6.0 million in facilities costs primarily resulting from additional network operations and security support. These factors were partially offset by a decrease due to an increase of $7.5 million in software and website development costs capitalized, a decrease of $2.1 million in stock-based compensation expense, and a decrease of $0.4 million in depreciation expense.

In 2016, we capitalized $27.9 million in eligible salary and consultant costs, including $1.4 million of stock-based compensation expense, associated with software developed or obtained for internal use, compared to $20.4 million, which included $1.2 million of stock-based compensation capitalized in 2015.

Our sales and marketing expense decreased $3.2 million, or 1%, in 2016 compared to 2015. As a percentage of net revenues, total sales and marketing expense decreased to 21% in 2016 from 22% in 2015. The decrease in sales and marketing expense was primarily driven by a decrease of $6.1 million in stock-based compensation expense due to executive departures in the first quarter of 2016 and full vesting of prior acquisition grants and a decrease of $4.4 million in depreciation and amortization expense. These factors were partially offset by an increase of $4.9 million from increased online advertising, an increase of $2.5 million in personnel and related costs due to an increase in headcount, and an increase of $0.4 million in professional fees.

Our general and administrative expense decreased $2.5 million, or 2%, in 2016 compared to 2015. As a percentage of net revenues, general and administrative expense decreased to 10% in 2016 as compared to 11% in 2015. The decrease in general and administrative expense is primarily due to a decrease of $6.9 million in stock-based compensation expense from the departure of our former Chief Executive Officer, a decrease in loss on asset disposals of $0.7 million, and a decrease in taxes and miscellaneous fees of $0.5 million. These factors were partially offset by an increase of $2.8 million in facility costs, an increase of $1.6 million in professional fees, an increase of $0.4 million personnel related costs, and an increase of $0.4 million in credit card fees.

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2016 | 2015 | CHANGE |
| | | (in thousands) | |
| Interest expense | $(23,023) | $(20,998) | $(2,025) |
| Interest and other income, net | 501 | 744 | (243) |

Interest expense was $23.0 million for the year ended December 31, 2016 compared to $21.0 million during 2015. This increase in interest expense was primarily driven by $0.9 million of financing obligations relating to our Tempe, Arizona facility recognizing a half year of interest as it became operational in the second quarter of 2015, an increase of $0.8 million in interest expense from our convertible debt compared to prior year, and additional equipment capital leases of $0.3 million compared to prior year.

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 2016 | 2015 |
| | (dollars in thousands) | |
| Income tax (expense) benefit | $(10,682) | $1,146 |
| Effective tax rate | 40% | 58% |

We recorded an income tax provision of $10.7 million for 2016, compared to a benefit of $1.1 million for 2015. Our effective tax rate was 40% in 2016 and 58% in 2015. Factors that impacted the effective tax rate include the federal research and development credit, limitation on executive compensation, disqualifying dispositions of employee incentive stock options, and an Israel Tax Authority audit assessment.

## *Liquidity and Capital Resources*

At December 31, 2017, we had $489.9 million of cash and cash equivalents and $187.3 million of investments, primarily commercial paper and corporate bonds. In May 2013, we issued $300.0 million of 0.25% convertible senior notes due May 15, 2018 (the "Senior Notes"). 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 expiring in August 2024 (the "Term Loan"). In October 2017, we fully drew the $300.0 million Term Loan facility and we anticipate using the proceeds from the Term Loan to repay the Senior Notes. The Revolving Loan Facility remains undrawn and available to us as of December 31, 2017.

In January 2018, we entered into a Stock Purchase Agreement (the "Purchase Agreement") with Lifetouch, Inc. ("Lifetouch") and Lifetouch Inc. Employee Stock Ownership Trust (the "Seller"), pursuant to which we will acquire 100% of the issued and outstanding shares of common stock of Lifetouch from the Seller for an all-cash purchase price of $825.0 million. We expect to close the acquisition of Lifetouch in the second quarter of 2018 and will finance the all-cash purchase price with an incremental $825.0 million term loan issuance. In connection with the Purchase Agreement, we entered into a commitment letter (the "Commitment Letter"), dated as of January 30, 2018, with Morgan Stanley Senior Funding, Inc. ("Morgan Stanley"), pursuant to which Morgan Stanley has committed to provide a secured incremental term loan facility in an aggregate amount of $825.0 million under our existing Credit Agreement. Issuance of the secured incremental term loan is subject to various conditions, including the execution of the definitive documentation and other customary closing conditions.

The $500.0 million credit facility that we entered into during 2017 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. Further, we suspended our share repurchase program as of December 31, 2017 and we have publicly committed to de-levering. For information about our repurchases of shares of our common stock during the years ended December 31, 2017 and 2016, see Part II, Item 8 of this annual report on Form 10-K "Financial Statements and Supplementary Data-Notes to Consolidated Financial Statements-Note 11-Share Repurchase Program."

Below is our cash flow activity for the years ended December 31, 2017, 2016 and 2015:

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| | (in thousands) | | |
| **CONSOLIDATED STATEMENTS OF CASH FLOWS DATA:** | | | |
| Purchases of property and equipment | $ (36,745) | $ (56,264) | $ (55,448) |
| Capitalization of software and website development costs | (34,006) | (33,423) | (21,221) |
| Depreciation and amortization | 103,862 | 113,651 | 113,277 |
| Acquisition of business and intangible assets, net of cash acquired | — | — | (127) |
| Cash flows provided by operating activities | 239,524 | 193,423 | 165,037 |
| Cash flows used in investing activities | (195,362) | (64,401) | (33,117) |
| Cash flows provided by (used in) financing activities | 156,508 | (128,661) | (223,600) |

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 Term Loan and repayment of the Senior Notes due in May 2018 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 anticipate that total 2018 capital expenditures will be approximately 5% of our expected 2018 net revenues. 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.

The following table shows total capital expenditures including amounts accrued but not yet paid by category for the years ended December 31, 2017, 2016 and 2015:

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| | | (in thousands) | |
| Technology equipment and software | $ 12,839 | $ 18,809 | $ 36,380 |
| *Percentage of total capital expenditures* | *18%* | *22%* | *45%* |
| Manufacturing equipment and building improvements | 23,523 | 30,836 | 18,478 |
| *Percentage of total capital expenditures* | *32%* | *36%* | *23%* |
| Capitalized technology and development costs | 33,609 | 33,104 | 22,113 |
| *Percentage of total capital expenditures* | *46%* | *39%* | *27%* |
| Rental Equipment | 3,077 | 2,606 | 4,407 |
| *Percentage of total capital expenditures* | *4%* | *3%* | *5%* |
| **TOTAL CAPITAL EXPENDITURES[1]** | **$73,048** | **$85,355** | **$81,378** |
| *Total capital expenditures percentage of net revenues* | *6%* | *8%* | *8%* |

[1] Excluding $9.8 million of printers we acquired and immediately sold in the second quarter of 2016, total capital expenditures in 2016 totaled $75.6 million, or 7% of net revenues.

*Operating Activities*. 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.

For 2015, net cash provided by operating activities was $165.0 million. Adjustments for non-cash items included $86.3 million of depreciation and amortization, which increased by $21.4 million over the prior year due to an increase in equipment capital leases and additional built-to-suit lease arrangements during the year. Additional adjustments for non-cash items included $60.5 million of stock-based compensation, and $27.0 million of amortization of intangible assets. Net cash provided by operating activities was also adjusted for amortization of debt discount and issuance costs of $13.6 million and the net change in operating assets and liabilities of $19.4 million primarily driven by a change in accounts receivable resulting from SBS customers.

*Investing Activities*. 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 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 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.

For 2015, net cash used in investing activities was $33.1 million. We used $55.4 million for capital expenditures, $31.1 million to purchase investments and $21.2 million for capitalized software and website development. This was partially offset from proceeds from the sales and maturities of investments of $73.5 million and proceeds from the sale of equipment and rental assets of $1.3 million, respectively.

*Financing Activities*. 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 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.

For 2015, net cash used in financing activities was $223.6 million. We used $215.9 million to repurchase shares of our common stock and $12.7 million for payments of capital leases and financing obligations. We also received $3.2 million of proceeds from issuance of common stock from the exercise of options and recorded $1.8 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 income (loss), Non-GAAP net income (loss) per share, adjusted EBITDA, adjusted EBITDA minus capital expenditures and free cash flow which meet the definition of Non-GAAP financial measures. 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, and benefit from the Tax Cuts and Jobs Act legislation. We define adjusted EBITDA as earnings before interest, taxes, depreciation, amortization, stock-based compensation, restructuring and capital lease termination charge. Adjusted EBITDA minus capital expenditures is defined as adjusted EBITDA less purchases of property and equipment and capitalization of software and website development costs. This was previously referred to as "free cash flow" prior to the fourth quarter of 2016. 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 income (loss), Non-GAAP net income (loss) per share, adjusted EBITDA, adjusted EBITDA minus capital expenditures 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 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 adjusted EBITDA minus capital expenditures and 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 income (loss), Non-GAAP net income (loss) per share, Non-GAAP adjusted EBITDA and Non-GAAP adjusted EBITDA minus capital expenditures as a percentage of net revenues for the years ended December 31, 2017, 2016, and 2015 (in thousands except per share amounts and percentages):

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Net revenues | $1,190,202 | $1,134,224 | $1,059,429 |
| GAAP net income (loss) | $ 30,085 | $ 15,906 | $ (843) |
| *GAAP net income (loss) % of net revenues* | *3%* | *1%* | *—%* |
| GAAP net income (loss) per share | $ 0.88 | $ 0.45 | $ (0.02) |
| Non-GAAP net income (loss) | $ 35,828 | $ 15,906 | $ (843) |
| *Non-GAAP net income (loss) % of net revenues* | *3%* | *1%* | *—%* |
| Non-GAAP net income (loss) per share | $ 1.05 | $ 0.45 | $ (0.02) |
| Non-GAAP adjusted EBITDA | $ 234,099 | $ 208,453 | $ 192,000 |
| *Non-GAAP adjusted EBITDA % of net revenues* | *20%* | *18%* | *18%* |
| Non-GAAP adjusted EBITDA minus capital expenditures | $ 161,051 | $ 132,925 | $ 110,621 |
| *Adjusted EBITDA minus capital expenditures % of net revenues* | *14%* | *12%* | *10%* |
| Free cash flow | $ 168,773 | $ 113,563 | $ 88,368 |
| *Free cash flow % of net revenues* | *14%* | *10%* | *8%* |

For 2017, 2016 and 2015, our Non-GAAP net income (loss) was $35.8 million, $15.9 million and $(0.8) million, respectively. In addition, for 2017, 2016 and 2015, Non-GAAP net income (loss) per share was $1.05, $0.45 and $(0.02). respectively.

For 2017, 2016 and 2015, our adjusted EBITDA was $234.1 million, $208.5 million and $192.0 million, respectively. In addition, for 2017, 2016 and 2015, adjusted EBITDA minus capital expenditures was $161.1 million, $132.9 million and $110.6 million.

For 2017, 2016 and 2015, our free cash flow was $168.8 million, $113.6 million and $88.4 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 adjusted EBITDA minus capital expenditures.

The following is a reconciliation of Non-GAAP net income (loss), Non-GAAP net income (loss) per share, adjusted EBITDA, adjusted EBITDA minus capital expenditures, free cash flow to the most comparable GAAP measure, for the years ended December 31, 2017, 2016 and 2015 (in thousands except per share amounts):

## Reconciliation of Net Income (loss) to Non-GAAP Net Income (Loss)

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **GAAP NET INCOME (LOSS)** | **$30,085** | **$15,906** | **$ (843)** |
| Capital lease termination | 8,098 | — | — |
| Restructuring | 16,966 | — | — |
| Tax benefit impact of restructuring and capital lease termination charges | (10,446) | — | — |
| Benefit from 2017 tax reform legislation | (8,875) | — | — |
| **NON-GAAP NET INCOME (LOSS)** | **$35,828** | **$15,906** | **$ (843)** |
| GAAP diluted shares outstanding | 34,106 | 35,190 | 36,761 |
| Non-GAAP diluted shares outstanding | 34,106 | 35,190 | 36,761 |
| **GAAP NET INCOME (LOSS) PER SHARE** | **$ 0.88** | **$ 0.45** | **$ (0.02)** |
| **NON-GAAP NET INCOME (LOSS) PER SHARE** | **$ 1.05** | **$ 0.45** | **$ (0.02)** |

## Reconciliation of Net Income (Loss) to Non-GAAP Adjusted EBITDA

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **NET INCOME (LOSS)** | **$ 30,085** | **$ 15,906** | **$ (843)** |
| Add back: | | | |
| Interest expense | 27,836 | 23,023 | 20,998 |
| Interest and other income, net | (1,481) | (501) | (744) |
| Tax expense (benefit) | 5,160 | 10,682 | (1,146) |
| Depreciation and amortization | 103,862 | 113,651 | 113,277 |
| Stock-based compensation expense | 43,573 | 45,692 | 60,458 |
| Capital lease termination | 8,098 | — | — |
| Restructuring | 16,966 | — | — |
| **NON-GAAP ADJUSTED EBITDA** | **$234,099** | **$208,453** | **$192,000** |

## Reconciliation of Cash Flow From Operating Activities to Non-GAAP Adjusted EBITDA and Adjusted EBITDA minus Capital Expenditures

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016[2] | 2015 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | **$239,524** | **$193,423** | **$165,037** |
| Add back: | | | |
| Interest expense | 27,836 | 23,023 | 20,998 |
| Interest and other income, net | (1,481) | (501) | (744) |
| Provision for (benefit from) income taxes | 5,160 | 10,682 | (1,146) |
| Changes in operating assets and liabilities | (34,634) | 3,772 | 19,393 |
| Other adjustments | (16,488) | (21,946) | (11,538) |
| Capital lease termination | 8,098 | — | — |
| Cash restructuring | 6,084 | — | — |
| **NON-GAAP ADJUSTED EBITDA** | **234,099** | **208,453** | **192,000** |
| Less: | | | |
| Purchases of property and equipment, including accrued amounts | (39,438) | (52,251) | (59,266) |
| Capitalized software and website development costs, including accrued amounts | (33,610) | (33,104) | (22,113) |
| Capex adjustments[1] | — | 9,827 | — |
| **ADJUSTED EBITDA MINUS CAPITAL EXPENDITURES** | **$161,051** | **$132,925** | **$110,621** |

[1] In the second quarter of 2016, we acquired and subsequently sold $9.8 million of printers.

[2] 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 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Net cash provided by operating activities | $ 239,524 | $ 193,423 | $165,037 |
| Less: capital expenditures[1] | 70,751 | 79,860 | 76,669 |
| **FREE CASH FLOW** | **$168,773** | **$113,563** | **$ 88,368** |

[1] Excludes purchase of printers of $9.8 million that we acquired and immediately sold during the second quarter of 2016

## Contractual Obligations

The following are contractual obligations at December 31, 2017, 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** | | | | | |
| Term Loan, including interest(1) | 388,492 | 16,044 | 33,062 | 32,805 | 306,581 |
| Convertible Senior Notes, including interest | 300,375 | 300,375 | — | — | — |
| Capital lease obligations | 73,301 | 19,400 | 26,038 | 17,849 | 10,014 |
| Operating lease obligations(2) | 32,052 | 7,287 | 13,626 | 11,069 | 70 |
| Build-to-suit lease obligations(3) | 46,247 | 6,358 | 13,146 | 13,741 | 13,002 |
| Purchase obligations(4) | 91,584 | 39,083 | 52,429 | 72 | — |
| **TOTAL CONTRACTUAL OBLIGATIONS** | **$932,051** | **$388,547** | **$138,301** | **$75,536** | **$329,667** |

(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 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 6—Derivative Financial Instruments and Note 12—Debt" for further discussion.

(2) Includes office space in Redwood City and Santa Clara, California and certain production 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 7—Commitments and Contingencies" for further discussion.

(4) Includes co-location agreements with third-party hosting facilities that expire in 2020, and an agreement to migrate to the cloud that expires in 2020 as well as minimums under marketing agreements.

In January 2018, we entered into a Purchase Agreement with Lifetouch and the Seller, pursuant to which we will acquire 100% of the issued and outstanding shares of common stock of Lifetouch from the Seller for an all-cash purchase price of $825.0 million. We expect to close the acquisition of Lifetouch in the second quarter of 2018 and will finance the all-cash purchase price with an incremental $825.0 million Term Loan issuance. In connection with the Purchase Agreement, we entered into a Commitment Letter with Morgan Stanley, pursuant to which Morgan Stanley has committed to provide a secured incremental term loan facility in an aggregate amount of $825.0 million under our existing Credit Agreement. Issuance of the secured incremental term loan is subject to various conditions, including the execution of the definitive documentation and other customary closing conditions.

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.

## 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 syndicated credit facility which provides (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 secured delayed draw term loan facility (“Term Loan”) in an aggregate principal amount of up to $300.0 million. We maintain our portfolio of cash equivalents and investments in a variety of agency bonds, commercial paper and corporate debt securities. All of our cash equivalents are carried at market value. 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. We do not believe that a 10% change in interest rates would have a significant impact on our interest income and expense, operating results, or liquidity. As of December 31, 2017, we have not borrowed any funds under our Revolving Loan Facility. However, in October 2017, we fully drew $300.0 million on the Term Loan facility.

In August 2017, in order to mitigate future interest-rate risk, we 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 our Term Loan so that the interest payable on such portion of the Term Loan become fixed at a rate of 4.27% (refer to Note 6 and Note 12 of Notes to Consolidated Financial Statements for further details regarding the 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, 2017, 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 $8.0 million.

Market Risk and Market Interest Risk. In May 2013, we issued $300.0 million of 0.25% convertible senior notes due May 15, 2018. We carry this instrument at face value less unamortized discount on our balance sheet. Since this instrument bears interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of these instruments fluctuates when interest rates change, and in the case of convertible notes, when the market price of our stock fluctuates. We do not believe these market fluctuations to have a significant impact on our operating results or liquidity.

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, agency bonds and corporate debt securities. As of December 31, 2017, our investments totaled $187.3 million, which represented approximately 41% of our total investment portfolio.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## SHUTTERFLY, INC.
## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS



### 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 as of December 31, 2017 and December 31, 2016, and the consolidated statements of operations, stockholders' equity, comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2017, 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, 2017, 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, 2017 and December 31, 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 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, 2017, based on criteria established in Internal Control—Integrated Framework (2013) issued by the COSO.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for certain elements of its employee share-based compensation in 2017.

### 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 the accompanying 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.

## 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 16, 2018

We have served as the Company's auditor since 2001.

## SHUTTERFLY, INC. CONSOLIDATED BALANCE SHEETS

(In thousands, except par value amounts)

| | DECEMBER 31, | |
|---|---|---|
| **ASSETS** | **2017** | **2016** |
| Current assets: | | |
| Cash and cash equivalents | $ 489,894 | $ 289,224 |
| Short-term investments | 178,021 | 26,352 |
| Accounts receivable, net | 82,317 | 57,365 |
| Inventories | 11,019 | 11,751 |
| Prepaid expenses and other current assets | 41,383 | 48,084 |
| **TOTAL CURRENT ASSETS** | **802,634** | **432,776** |
| Long-term investments | 9,242 | 14,479 |
| Property and equipment, net | 266,860 | 284,110 |
| Intangible assets, net | 29,671 | 43,420 |
| Goodwill | 408,975 | 408,975 |
| Other assets | 17,418 | 11,816 |
| **TOTAL ASSETS** | **$1,534,800** | **$1,195,576** |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ 297,054 | $ — |
| Accounts payable | 91,473 | 58,790 |
| Accrued liabilities | 159,248 | 138,869 |
| Deferred revenue, current portion | 24,649 | 22,929 |
| **TOTAL CURRENT LIABILITIES** | **572,424** | **220,588** |
| Long-term debt | 292,457 | 278,792 |
| Other liabilities | 119,195 | 137,035 |
| **TOTAL LIABILITIES** | **984,076** | **636,415** |
| Commitments and contingencies (Note 7) | | |
| Stockholders' equity: | | |
| Common stock, $0.0001 par value; 100,000 shares authorized; 32,297 and 33,637 shares issued and outstanding on December 31, 2017 and December 31, 2016, respectively | 3 | 3 |
| Additional paid-in capital | 996,301 | 949,864 |
| Accumulated other comprehensive income (loss) | 1,778 | (32) |
| Accumulated deficit | (447,358) | (390,674) |
| **TOTAL STOCKHOLDERS' EQUITY** | **550,724** | **559,161** |
| **TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY** | **$1,534,800** | **$1,195,576** |

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, | | |
|---|---|---|---|
| | **2017** | **2016** | **2015** |
| Net revenues | $1,190,202 | $1,134,224 | $1,059,429 |
| Cost of net revenues | 619,650 | 566,117 | 528,078 |
| Restructuring | 1,475 | — | — |
| **GROSS PROFIT** | **569,077** | **568,107** | **531,351** |
| Operating expenses: | | | |
| Technology and development | 168,383 | 166,909 | 155,318 |
| Sales and marketing | 197,708 | 233,585 | 236,749 |
| General and administrative | 117,797 | 118,503 | 121,019 |
| Capital lease termination | 8,098 | — | — |
| Restructuring | 15,491 | — | — |
| **TOTAL OPERATING EXPENSES** | **507,477** | **518,997** | **513,086** |
| Income from operations | 61,600 | 49,110 | 18,265 |
| Interest expense | (27,836) | (23,023) | (20,998) |
| Interest and other income, net | 1,481 | 501 | 744 |
| **INCOME (LOSS) BEFORE INCOME TAXES** | **35,245** | **26,588** | **(1,989)** |
| (Provision for) benefit from income taxes | (5,160) | (10,682) | 1,146 |
| **NET INCOME (LOSS)** | **$ 30,085** | **$ 15,906** | **$ (843)** |
| Net income (loss) per share: | | | |
| Basic | $ 0.91 | $ 0.47 | $ (0.02) |
| **DILUTED** | **$ 0.88** | **$ 0.45** | **$ (0.02)** |
| Weighted average shares: | | | |
| Basic | 33,113 | 34,097 | 36,761 |
| **DILUTED** | **34,106** | **35,190** | **36,761** |
| Stock-based compensation is allocated as follows (Note 8): | | | |
| Cost of net revenues | $ 4,339 | $ 4,579 | $ 4,134 |
| Technology and development | 9,778 | 8,550 | 10,840 |
| Sales and marketing | 12,229 | 15,445 | 21,512 |
| General and administrative | 17,227 | 17,118 | 23,972 |
| Restructuring | 814 | — | — |
| | $ 44,387 | $ 45,692 | $ 60,458 |

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, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **COMMON STOCK (PAR VALUE)** | | | |
| Balance, beginning of year | $ 3 | $ 4 | $ 4 |
| Issuance of common stock upon exercise of options and vesting of restricted stock units | 1 | 1 | 1 |
| Common stock repurchased and retired | (1) | (2) | (1) |
| **BALANCE, END OF YEAR** | **3** | **3** | **4** |
| **ADDITIONAL PAID-IN CAPITAL** | | | |
| Balance, beginning of year | 949,864 | 900,218 | 838,313 |
| Issuance of common stock upon exercise of options and vesting of restricted stock units | 677 | 2,104 | 3,221 |
| Stock based compensation, net of forfeitures | 45,760 | 47,252 | 61,705 |
| Accelerated share repurchase of common stock | — | — | (3,119) |
| Tax benefit (shortfall) of stock options | — | 290 | 98 |
| **BALANCE, END OF YEAR** | **996,301** | **949,864** | **900,218** |
| **ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)** | | | |
| Balance, beginning of year | (32) | (68) | (53) |
| Unrealized gain (loss) on investments, net of tax | (27) | 36 | (15) |
| Unrealized gain on cash flow hedges, net of tax | 1,837 | — | — |
| **BALANCE, END OF YEAR** | **1,778** | **(32)** | **(68)** |
| **ACCUMULATED DEFICIT** | | | |
| Balance, beginning of year | (390,674) | (294,092) | (80,458) |
| Impact of adoption of new accounting standard | 23,231 | — | — |
| Common stock repurchased and retired | (110,000) | (112,488) | (212,791) |
| Net income (loss) | 30,085 | 15,906 | (843) |
| **BALANCE, END OF YEAR** | **(447,358)** | **(390,674)** | **(294,092)** |
| **TOTAL STOCKHOLDERS' EQUITY** | **$ 550,724** | **$ 559,161** | **$ 606,062** |
| **NUMBER OF SHARES** | | | |
| Common stock | | | |
| Balance, beginning of year | 33,637 | 34,777 | 37,906 |
| Issuance of common stock upon exercise of options and vesting of restricted stock units | 986 | 1,385 | 1,780 |
| Common stock repurchased and retired | (2,326) | (2,525) | (4,909) |
| **BALANCE, END OF YEAR** | **32,297** | **33,637** | **34,777** |

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, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Net income (loss) | $ 30,085 | $ 15,906 | $ (843) |
| Other comprehensive income (loss), net of reclassification adjustments: | | | |
| Unrealized gains (losses) on investments, net | (72) | 66 | (24) |
| Tax benefit (expense) on unrealized gains (losses) on investments, net | 39 | (30) | 9 |
| Unrealized gains on cash flow hedges | 2,979 | — | — |
| Tax expense on unrealized gains on cash flow hedges | (1,136) | — | — |
| **OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX** | **1,810** | **36** | **(15)** |
| **COMPREHENSIVE INCOME (LOSS)** | **$31,895** | **$15,942** | **$(858)** |

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, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net income (loss) | $ 30,085 | $ 15,906 | $ (843) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Depreciation and amortization | 88,946 | 93,531 | 86,290 |
| Amortization of intangible assets | 14,916 | 20,120 | 26,987 |
| Amortization of debt discount and issuance costs | 15,508 | 14,432 | 13,647 |
| Stock-based compensation | 43,573 | 45,692 | 60,458 |
| Loss on disposal of property and equipment | 1,141 | 738 | 1,755 |
| Deferred income taxes | (161) | 8,899 | (2,149) |
| Tax benefit from stock-based compensation | — | 290 | 98 |
| Excess tax benefits from stock-based compensation | — | (2,413) | (1,813) |
| Restructuring | 10,882 | — | — |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | (24,952) | (2,142) | (24,117) |
| Inventories | (743) | 1,715 | (450) |
| Prepaid expenses and other assets | 5,603 | (19,140) | (7,436) |
| Accounts payable | 32,189 | 27,128 | 3,139 |
| Accrued and other liabilities | 22,537 | (11,333) | 9,471 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | **239,524** | **193,423** | **165,037** |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Purchases of property and equipment | (36,745) | (56,264) | (55,448) |
| Capitalization of software and website development costs | (34,006) | (33,423) | (21,221) |
| Purchases of investments | (205,466) | (29,422) | (31,073) |
| Proceeds from the maturities of investments | 45,257 | 28,234 | 62,944 |
| Proceeds from the sales of investments | 13,874 | 12,213 | 10,510 |
| Proceeds from sale of property and equipment | 21,724 | 14,261 | 1,298 |
| Acquisition of business and intangible assets, net of cash acquired | — | — | (127) |
| **NET CASH USED IN INVESTING ACTIVITIES** | **(195,362)** | **(64,401)** | **(33,117)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Proceeds from issuance of common stock upon exercise of stock options | 677 | 2,104 | 3,221 |
| Repurchases of common stock | (110,000) | (112,488) | (179,090) |
| Prepayment of accelerated share repurchase | — | — | (75,000) |
| Refund of accelerated share repurchase | — | — | 38,179 |
| Excess tax benefits from stock-based compensation | — | 2,413 | 1,813 |
| Principal payments of capital lease and financing obligations | (29,380) | (19,377) | (12,723) |
| Payment for contingent consideration liabilities | — | (1,313) | — |
| Proceeds from borrowings, net of issuance costs | 295,211 | — | — |
| **NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES** | **156,508** | **(128,661)** | **(223,600)** |
| Net increase (decrease) in cash and cash equivalents | 200,670 | 361 | (91,680) |
| Cash and cash equivalents, beginning of period | 289,224 | 288,863 | 380,543 |
| **CASH AND CASH EQUIVALENTS, END OF PERIOD** | **$ 489,894** | **$ 289,224** | **$ 288,863** |

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, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:** | | | |
| Cash paid during the period for: | | | |
| Interest | $ 5,567 | $ 3,231 | $ 2,798 |
| Income taxes | 780 | 1,561 | 1,056 |
| **SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING / FINANCING ACTIVITIES:** | | | |
| Net increase (decrease) in accrued purchases of property and equipment | $ 2,693 | $ (4,013) | $ 3,818 |
| Net (decrease) increase in accrued capitalized software and website development costs | (396) | (319) | 892 |
| Stock-based compensation capitalized with software and website development costs | 1,373 | 1,560 | 1,247 |
| Increase in estimated fair market value of buildings under build-to-suit leases | — | — | 17,161 |
| Property and equipment acquired under capital leases | 19,145 | 23,946 | 29,097 |

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") was incorporated in the state of Delaware in 1999. In September 2006, the Company completed its initial public offering and its common stock is listed on The Nasdaq Global Select Market under the symbol "SFLY." The Company's principal corporate offices are in Redwood City, California.

Shutterfly is the leading digital retailer and manufacturer of high-quality personalized products and services. Shutterfly's purpose is to share life's joy by connecting people to what matters as the leading retailer and manufacturing platform for personalized products. Shutterfly provides a full range of personalized photo-based products and services that make it easy, convenient and fun for consumers to upload, edit, enhance, organize, find, share, create, print, and preserve their memories in a creative and thoughtful manner.

The Company operates trusted premium lifestyle brands: Shutterfly, Tiny Prints, BorrowLenses and Groovebook.

## 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. The functional currency of its Israeli subsidiary is the U.S. Dollar, as such, exchange rate fluctuations are recorded as a part of earnings. All intercompany transactions and balances have been eliminated.

### 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 three months 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, 2017, 2016 or 2015.

## 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, 2017, 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 who make payments through credit cards, sales of the Company's products in sales of SBS services and revenue generated from online advertisements posted on the Company's websites. 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, 2017, two SBS customers accounted for 55% and 35% of the Company's net accounts receivable. No other customers accounted for more than 10% of net accounts receivable as of December 31, 2017. As of December 31, 2016, excluding amounts due from credit cards of customers, one SBS customers accounted for 33% of the Company's net accounts receivable. No other customers accounted for more than 10% of net accounts receivable as of December 31, 2016. No customers accounted for more than 10% of net revenues in the years ended December 31, 2017, 2016, and 2015.

## 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 covers, 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 historical 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 revenues and operating expenses. Rental assets are depreciated over their estimated useful lives, generally five to six years as component of cost of net revenues, 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 revenues. 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 minor enhancements and maintenance for the Company's websites 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 revenues 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 two 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 unit 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 revenues and operating expenses, based primarily on expected reporting unit expansion, pricing, market segment share, and general economic conditions.

## Intellectual Property Prepaid Royalties

The Company has patent license agreements with various third parties. The Company has accounted for these agreements as prepaid royalties that are amortized over the remaining life of the patents. Amortization expense is recorded on a straight-line basis as a component of cost of revenue. The current portion of the prepaid royalty is recorded as a component of prepaid expenses and the long-term portion is recorded in other assets.

## 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 regards 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 lease 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 leases, 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 recognizes revenue from Consumer and SBS product sales, net of applicable sales tax, upon shipment of fulfilled orders, when persuasive evidence of an arrangement exists, the selling price is fixed or determinable and collection of resulting receivables is reasonably assured. Customers place Consumer product orders through the Company's websites or mobile apps and pay primarily using credit cards. SBS customers are invoiced upon fulfillment. Shipping charged to customers is recognized as revenue at the time of shipment and the related shipping costs are recognized as cost of net revenues.

For gift card sales and flash deal promotions through group-buying websites, the Company recognizes revenue on a gross basis, as it is the primary obligor, when redeemed items are shipped. Revenues from sales of prepaid orders on its websites are deferred until shipment of fulfilled orders or until unredeemed prepaid orders are recognized as breakage revenue. Unredeemed prepaid orders are recognized as breakage revenue based on historical redemption patterns and represent orders for which the Company believes customer redemption is remote and it is not probable that the Company has an obligation to escheat the value of the prepaid order under unclaimed property laws.

In the second quarter of 2015, the Company changed its accounting estimate related to flash deal deferred revenue. Beginning in 2010, the Company began to market product offers on flash deal websites such as Groupon and LivingSocial. With limited history as to customer redemption patterns, the Company had been deferring all amounts to a flash deal deferred revenue liability until customer redemption. The Company now has sufficient relevant historical flash deal redemption data to support a change in estimate of the flash deal deferred revenue based on historical customer redemption patterns. Flash deal breakage revenue is recognized based upon its historical redemption patterns and represents the unredeemed flash deal offers for which the Company believes customer redemption is remote and it is not probable that the Company has an obligation to escheat the value of the flash deal revenue under unclaimed property laws. During the years ended December 31, 2017, 2016 and 2015, the Company recognized flash deal breakage revenue of $1.4 million, $5.3 million and $10.0 million, respectively.

The Company provides its customers with a return policy whereby products can be returned during a reasonable period of time for a reprint or refund. The Company maintains an allowance for estimated future returns based on historical data. The provision for estimated returns is included in accrued expenses.

The Company periodically provides incentive offers to its customers in exchange for setting up an account and to encourage purchases. Such offers include free products and percentage discounts on current purchases. Discounts, when accepted by customers, are treated as a reduction to the purchase price of the related transaction and are presented in net revenues. Production costs related to free products are included in cost of revenues upon redemption.

The Company's advertising revenues are derived from the sale of online advertisements on its websites. Advertising revenues are recognized as "impressions" (i.e., the number of times that an advertisement appears in pages viewed by users of the Company's websites) are delivered; as "clicks" (which are generated each time users of the Company's websites click through the advertisements to an advertiser's designated website) are provided to advertisers; or ratably over the term of the agreement with the expectation that the advertisement will be delivered ratably over the contract period.

Certain SBS revenue arrangements with multiple deliverables, including products and services, are divided into separate units and revenue is allocated using estimated selling prices if the Company does not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables. The Company allocated the arrangement price to each of the elements based on the relative selling prices of each element. Estimated selling prices are management's best estimates of the prices that the Company would charge its customers if the Company were to sell the standalone elements separately and include considerations of customer demand, prices charged by the Company and others for similar deliverables, and the price if largely based on the cost of producing the product or service. For up-front fees the Company received in exchange for products delivered or services performed, it is deferred and recognized over periods that the fees are earned. In cases in which an up-front fee is not related to specific products or services, the fee is excluded from the consideration that is allocated to the deliverables, and is recognized over the longer of the initial contractual term of the arrangement or the estimated period the customer is expected to benefit from the payment of the up-front fee.

For camera, lenses, and video equipment rentals from the BorrowLenses brand, the Company recognizes rental revenue and the related shipping revenue, ratably over the rental period. Revenue from the sale of rental equipment is recognized upon shipment of the equipment.

## 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 vacates 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 capitalized direct mail costs at December 31, 2017 and 2016. 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 $95.6 million, $122.1 million and $117.1 million during the years ended December 31, 2017, 2016 and 2015, 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 awards ("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 awards ("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 is recognized on an accelerated attribution model. As of December 31, 2017, the PBRSUs are only subject to service vesting conditions as the performance criteria has been met.

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 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 and Israel.

On December 22, 2017, H.R.1 "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal year 2018" commonly referred to as the Tax Cuts and Jobs Act (the "Act" or "Tax Reform") was signed by the President of the United States and became enacted law. The Tax Reform is complex and includes various changes which will impact the Company. The Company performed a preliminary assessment of the Tax Reform impacts and recorded an $8.9 million non-cash benefit due to the revaluation of our federal deferred tax liabilities in the fourth quarter of 2017, as a result of the reduction in the U.S. federal statutory tax rate from 35% to 21%.

## Net Income (Loss) Per Share

Basic net income (loss) per share attributed to common shares is computed by dividing the net income (loss) attributable to common shares for the period by the weighted average number of common shares outstanding during the period.

Diluted net income (loss) 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, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| | (in thousands, except per share amounts) | | |
| **NET INCOME (LOSS) PER SHARE:** | | | |
| **NUMERATOR** | | | |
| **NET INCOME (LOSS)** | **$30,085** | **$15,906** | **$ (843)** |
| **DENOMINATOR** | | | |
| Denominator for basic net income (loss) per share | | | |
| Weighted-average common shares outstanding | 33,113 | 34,097 | 36,761 |
| Dilutive effect of stock options and restricted awards | 993 | 1,093 | — |
| **DENOMINATOR FOR DILUTED NET INCOME PER SHARE** | **34,106** | **35,190** | **36,761** |
| **NET INCOME (LOSS) PER SHARE** | | | |
| Basic | $ 0.91 | $ 0.47 | $ (0.02) |
| **DILUTED** | **$ 0.88** | **$ 0.45** | **$ (0.02)** |

The following weighted-average outstanding stock options and restricted stock units were excluded from the computation of diluted net income (loss) per common share for the periods presented because including them would have had an anti-dilutive effect (in thousands):

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Stock options and restricted stock units | 1,363 | 549 | 4,185 |

## 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 and unrealized gains and losses on cash flow hedges.

## Segment Reporting

The Company reports as two operating segments with the Chief Executive Officer acting as the Company's chief operating decision maker. The Company defined two 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:

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, home décor, personalized gifts, high quality prints, and other photo-based merchandise, and the related shipping revenues as well as rental revenue from its BorrowLenses brand. Revenue from advertising displayed on the Company's websites is also included in Consumer revenues.

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.

In addition to the above reportable segments, the Company has a corporate category that includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation and amortization of intangible assets.

## Recent Accounting Pronouncements

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.

In 2014, the FASB issued new accounting guidance related to revenue recognition. 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 for those goods or services. In 2016, the FASB issued several amendments to the standard, including principal versus agent considerations when another party is involved in providing goods or services to a customer, the application of identifying performance obligations, and the recognition of expected breakage amounts proportionally in earnings as redemptions occur. The Company has concluded that there is an impact related to timing and measurement of breakage revenue for the consumer business and for one of the Company's significant multiple-element arrangements in connection with the SBS business. As it relates to timing and measurement of breakage revenue, the Company will recognize the expected breakage amounts as revenue in proportion to the pattern of rights exercised by the customer, rather than the current method of recognizing breakage revenue when the Company believes the redemption is remote. As it relates to timing and measurement of one of the Company's multiple-element arrangements in connection with the SBS business, deferred revenue is currently recognized over the stated term of the contract. Upon adoption of the new standard, revenue for these particular arrangements will be recognized over a period of time that is shorter than the stated contract term, as these arrangements do not contain substantive termination penalties after certain initial number of years within the contractual term. The standard is required to be applied using either of two methods: (1) retrospectively to each prior reporting period presented ("full retrospective method") or (2) retrospectively with the cumulative effect of initially applying the new revenue guidance recognized as an adjustment to accumulated deficit at the date of initial application and providing certain additional disclosures ("modified retrospective method"). The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company adopted the new revenue recognition guidance in the first quarter of fiscal 2018 pursuant to the modified retrospective method. The impact of the adoption is less than 1% of total revenue and did not result in significant changes to systems, processes or controls.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* The new guidance requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 on a modified retrospective basis, and earlier adoption is permitted. The Company is evaluating the impact of adopting this new accounting guidance 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 August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments.* The new guidance clarifies the classification of certain cash receipts and cash payments in the statement of cash flows, including debt prepayment or extinguishment costs, settlement of contingent consideration arising from a business combination, insurance settlement proceeds, and distributions from certain equity method investees. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company is evaluating the impact of adopting this new accounting guidance on the 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.

## Note 3—Balance Sheet Components

### Intellectual Property Prepaid Royalties

Intellectual property prepaid royalties are included in prepaid expenses and other current assets and other assets. Total amortization for these license agreements in 2017, 2016 and 2015 were $1.2 million, $1.2 million and $1.3 million, respectively. As of December 31, 2017, the Company had a balance of $5.6 million in unamortized prepaid royalties. Amortization of these licenses is estimated as follows (in thousands):

| YEAR ENDING DECEMBER 31: | |
|---|---|
| 2018 | $1,083 |
| 2019 | 675 |
| 2020 | 502 |
| 2021 | 502 |
| 2022 | 493 |
| Thereafter | 2,365 |
| | $5,620 |

### Prepaid Expenses and Other Current Assets

| | DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Prepaid service contracts – current portion | $12,861 | $11,114 |
| Manufacturing partners receivable | 6,322 | 11,739 |
| Prepaid postage | 3,274 | 4,754 |
| Other prepaid expenses and current assets | 18,926 | 20,477 |
| | $41,383 | $48,084 |

### Property and Equipment, Net

| | DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Manufacturing equipment | $ 192,494 | $ 182,484 |
| Computer equipment and software | 188,593 | 177,525 |
| Capitalized software and website development costs | 134,585 | 134,427 |
| Buildings under build-to-suit leases | 56,468 | 56,468 |
| Leasehold improvements | 22,145 | 22,007 |
| Rental equipment | 19,208 | 18,786 |
| Furniture and fixtures | 8,255 | 11,057 |
| | 621,748 | 602,754 |
| Less: Accumulated depreciation and amortization | (354,888) | (318,644) |
| **PROPERTY AND EQUIPMENT, NET** | **$266,860** | **$284,110** |

Building value of $56.5 million under build-to-suit leases represents the estimated fair market value of buildings under build-to-suit leases of which the Company is the “deemed owner” for accounting purposes only. See *Note 7—Commitments and Contingencies* for further discussion of the Company’s build-to-suit leases.

Included within Manufacturing equipment is approximately $89.9 million of capital lease obligations for various pieces of manufacturing facility equipment in 2017 and 2016. Accumulated depreciation of assets under capital lease totaled $32.4 million at December 31, 2017 compared to $25.1 million at December 31, 2016.

Rental equipment includes camera lenses, camera bodies, video equipment and other camera peripherals which are rented through the BorrowLenses website.

Depreciation and amortization expense totaled $88.9 million, $93.5 million, and $86.3 million for the years ended December 31, 2017, 2016 and 2015, respectively.

Included in property and equipment is approximately $15.8 million and $14.3 million of assets in construction as of December 31, 2017 and 2016, respectively, the majority of which relates to internal-use software.

Total capitalized software and website development costs, net of accumulated amortization totaled $57.4 million and $50.8 million at December 31, 2017 and 2016, respectively. Amortization of capitalized costs totaled approximately $26.8 million, $22.0 million and $18.7 million for the years ended December 31, 2017, 2016 and 2015, respectively.

During the second quarter of 2017, the Company took advantage of an opportunity to complete the upgrade of the majority of its color printer fleet. The benefits of the upgrade include improved quality, increased throughput and automation, and lower consumable costs. There are three pieces of this transaction as follows:

- Purchase of leased equipment from an existing vendor for $21.6 million;
- Sale of the purchased leased equipment to HP, Inc. (“HP”) for $20.5 million; and
- Lease of new equipment from HP.

In the purchase of the existing leased equipment, the difference between the payment of $21.6 million and the fair value of the asset resulted in an $8.1 million capital lease termination charge (a separate line item in the consolidated statement of operations). The purchased equipment assets were recorded on the balance sheet at fair value of $12.9 million. The subsequent sale of the equipment to HP for $20.5 million resulted in the removal of the equipment assets and a capital lease incentive of $7.9 million to be amortized over the new lease term. Lastly, the Company leased new equipment from HP which upgraded most of its remaining color fleet to HP’s high-end printers.

## Intangible Assets

Intangible assets are comprised of the following:

| | WEIGHTED AVERAGE USEFUL LIFE | DECEMBER 31, 2017 | DECEMBER 31, 2016 |
|---|---|---|---|
| | | (in thousands) | |
| Purchased technology | 10 years | $104,869 | $104,869 |
| Less: accumulated amortization | | (76,585) | (69,768) |
| | | 28,284 | 35,101 |
| Customer relationships | 5 years | 75,146 | 75,146 |
| Less: accumulated amortization | | (73,759) | (67,311) |
| | | 1,387 | 7,835 |
| Licenses and other | 3 years | 7,202 | 7,202 |
| Less: accumulated amortization | | (7,202) | (6,718) |
| | | — | 484 |
| **TOTAL** | | **$ 29,671** | **$ 43,420** |

Purchased technology is amortized over a period ranging from one to sixteen years. Customer relationships are amortized over a period ranging from one to seven years. Licenses and other is amortized over a period ranging from two to five years.

Intangible asset amortization expense for the years ended December 31, 2017, 2016 and 2015 was $13.7 million, $18.9 million and $25.8 million, respectively. Amortization of existing intangible assets is estimated to be as follows (in thousands):

| YEAR ENDING DECEMBER 31: | |
|---|---|
| 2018 | $ 4,829 |
| 2019 | 3,408 |
| 2020 | 3,407 |
| 2021 | 3,407 |
| 2022 | 3,407 |
| Thereafter | 11,213 |
| | $29,671 |

## Goodwill

The Company conducted its annual impairment assessment (Step One Analysis) test during the fourth quarter of 2017 in accordance with authoritative guidance. 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.

As of December 31, 2017, the Company's total goodwill balance is $409.0 million, with $372.1 million related to the Consumer segment and $36.9 million related to the SBS segment. There were no changes to the Company's goodwill balances in 2017 and 2016.

## Accrued Liabilities

| | DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Accrued production costs | $ 37,552 | $ 38,755 |
| Accrued compensation | 31,331 | 17,066 |
| Accrued marketing expenses | 22,874 | 23,839 |
| Accrued income, sales and other taxes | 21,745 | 19,846 |
| Capital lease obligations, current portion | 16,859 | 16,092 |
| Accrued other | 28,887 | 23,271 |
| | **$159,248** | **$138,869** |

## Other Liabilities

| | DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Financing obligations | $ 53,682 | $ 55,355 |
| Capital lease obligations, non-current portion | 48,620 | 50,213 |
| Deferred revenue, non-current portion | 5,618 | 7,303 |
| Deferred tax liability | 1,012 | 20,446 |
| Other liabilities | 10,263 | 3,718 |
| | **$119,195** | **$137,035** |

Financing obligations relate to the Company's build-to-suit leases as further discussed in *Note 7—Commitments and Contingencies*.

## Note 4—Investments

At December 31, 2017 and 2016, the estimated fair value of short-term and long-term investments classified as available for sale are as follows (in thousands):

| | DECEMBER 31, 2017 | | | |
|---|---|---|---|---|
| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | ESTI MATED 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** |

| | DECEMBER 31, 2016 | | | |
|---|---|---|---|---|
| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | ESTIMATED FAIR VALUE |
| **SHORT-TERM INVESTMENTS** | | | | |
| Corporate debt securities | $ 13,371 | $ 2 | $ (12) | $ 13,361 |
| Agency securities | 7,957 | 6 | — | 7,963 |
| Commercial paper | 1,727 | — | — | 1,727 |
| U.S. Government securities | 3,298 | 3 | — | 3,301 |
| **TOTAL SHORT-TERM INVESTMENTS** | **$26,353** | **$11** | **$(12)** | **$26,352** |
| **LONG-TERM INVESTMENTS** | | | | |
| Corporate debt securities | $ 6,208 | $ 1 | $ (20) | $ 6,189 |
| Agency securities | 5,359 | — | (20) | 5,339 |
| U.S. Government securities | 2,956 | 1 | (6) | 2,951 |
| **TOTAL LONG-TERM INVESTMENTS** | **$14,523** | **$ 2** | **$(46)** | **$14,479** |

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, 2017, 2016 and 2015 and no impairments were recorded in the respective periods. The Company had no material realized gains or losses during the years ended December 31, 2017 and 2016.

The following table summarizes the contractual maturities of the Company's investments as of December 31, 2017 and 2016 (in thousands):

| | DECEMBER 31, 2017 | DECEMBER 31, 2016 |
|---|---|---|
| One year or less | $ 178,021 | $ 26,352 |
| One year through three years | 9,242 | 14,479 |
| | **$187,263** | **$40,831** |

Actual maturities may differ from the contractual maturities because borrowers may have certain prepayment conditions.

## Note 5—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, 2017.

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, 2017 | | DECEMBER 31, 2016 | |
| | CASH EQUIVALENTS | INVESTMENTS | CASH EQUIVALENTS | INVESTMENTS |
| **LEVEL 1 SECURITIES:** | | | | |
| Money market funds | $ 151,071 | $ — | $ 808 | $ — |
| **LEVEL 2 SECURITIES:** | | | | |
| Corporate debt securities | 21,592 | 61,124 | 2,309 | 19,550 |
| Agency securities | 6,444 | 12,750 | — | 13,302 |
| U.S. Government securities | — | 11,843 | — | 6,252 |
| Commercial Paper | 85,599 | 101,546 | 6,694 | 1,727 |
| **TOTAL CASH EQUIVALENTS AND INVESTMENTS** | **$264,706** | **$187,263** | **$9,811** | **$40,831** |

## Derivative Assets

As of December 31, 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, volatilities and basis spreads (Level 2), were as follows (the Company had no outstanding derivative financial instruments as of December 31, 2016) (in thousands):

| | TOTAL ESTIMATED FAIR VALUE AS OF DECEMBER 31, 2017 |
|---|---|
| **DERIVATIVE ASSETS** | **$2,979** |

## Borrowings

As of December 31, 2017, and 2016, the fair value of the Company's borrowings, which was 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, 2017 | DECEMBER 31, 2016 |
| Convertible senior notes | $296,550 | $290,436 |
| Term Loan | 300,000 | — |

The Term Loan was issued in October 2018. Therefore, there was no balance as of December 31, 2016.

The carrying value of other financial instruments, including accounts receivable, accounts payable and other payables, approximates fair value due to their short maturities.

## Note 6—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 secured delayed draw term loan ("Term Loan") so that the interest payable on such portion of the Term Loan become fixed at a rate of 4.27% (refer to Note 12—*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 Term Loan. Further, the 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 Term Loan, including interest-rate reset dates and underlying market indices. The Company fully drew the 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). Refer to *Note 2—Summary of Significant Accounting Policies* for details regarding the derivative instruments accounting policy.

The fair value of the Swap Agreements was $3.0 million as of December 31, 2017 and was classified as other assets in the balance sheet. The unrealized gains recognized in other comprehensive income (loss) were $3.0 million and the amounts reclassified from other comprehensive income (loss) to interest expense during the year ended December 31, 2017 were insignificant. Amounts expected to be reclassified from other comprehensive income into interest expense in the coming 12 months are also insignificant. Interest expense (including the effects of the cash flow hedges) related to the portion of the Term Loan subject to the aforementioned interest-rate swap agreements was $1.3 million for the year ended December 31, 2017.

The Company does not use derivative financial instruments for trading purposes.

## Note 7—Commitments and Contingencies

### Leases

The Company leases office and production space under various non-cancelable operating leases that expire no later than January 2023. Rent expense was $7.1 million, $6.1 million. and $9.7 million, for the years ended December 31, 2017, 2016 and 2015, 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, 2017, the Company entered into new equipment leases with terms which resulted in capital lease treatment.

At December 31, 2017, the total future minimum payments under non-cancelable operating and capital leases are as follows (in thousands):

| | OPERATING LEASES | CAPITAL LEASES |
|---|---|---|
| **YEAR ENDING DECEMBER:** | | |
| 2018 | $ 7,287 | $ 19,400 |
| 2019 | 7,322 | 16,471 |
| 2020 | 6,304 | 9,567 |
| 2021 | 6,146 | 8,965 |
| 2022 | 4,923 | 8,884 |
| Thereafter | 70 | 10,014 |
| **TOTAL MINIMUM LEASE PAYMENTS** | **$32,052** | **$73,301** |
| **LESS: AMOUNT REPRESENTING INTEREST** | | **(7,822)** |
| Present value of future minimum lease payments | | 65,479 |
| Less: current portion | | (16,859) |
| **NON-CURRENT PORTION OF CAPITAL LEASE OBLIGATIONS** | | **$48,620** |

Total future minimum sublease income to be received from non-cancelable leases is $0.7 million as of December 31, 2017.

Purchase obligations consist of non-cancelable marketing and service agreements and co-location services that expire at various dates through the year 2021. As of December 31, 2017, the Company's purchase obligations totaled $91.6 million. At December 31, 2017, the total future minimum payments under these purchase obligations are as follows (in thousands):

| YEAR ENDING DECEMBER: | |
|---|---|
| 2018 | $ 39,083 |
| 2019 | 32,021 |
| 2020 | 20,408 |
| 2021 | 72 |
| **TOTAL MINIMUM PURCHASE OBLIGATIONS** | **$91,584** |

## Build-to-suit Lease

The Company completed the following construction of facilities in the 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 840-40 Leases—Sale-Leaseback Transactions. 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, 2017, the total future rent payments under these build-to-suit leases are as follows (in thousands):

| YEAR ENDING DECEMBER: | |
|---|---|
| 2018 | $ 6,358 |
| 2019 | 6,501 |
| 2020 | 6,645 |
| 2021 | 6,794 |
| 2022 | 6,947 |
| Thereafter | 13,002 |
| **TOTAL FUTURE RENT PAYMENTS UNDER BUILD-TO-SUIT LEASES** | **$46,247** |

## 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.

## 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 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 or results of operations.

## The State of Delaware v. Shutterfly, Inc.

On May 1, 2014, the State of Delaware filed a complaint against Shutterfly for alleged violations of the Delaware False Claims and Reporting Act, 6 Del C. § 1203(b)(2). The complaint asserts that Shutterfly failed to report and remit to Delaware cash equal to the balances on unused gift cards under the Delaware Escheats Law, 12 Del. C. § 1101 et seq. The Company believes the suit is without merit.

## Monroy v. Shutterfly, Inc.

On November 30, 2016, Alejandro Monroy on behalf of himself and all others similarly situated, filed a complaint against us in the U.S. District Court for the Northern District of Illinois. The complaint asserts that the Company 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 the Company 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 the Company. The Company believes the suit is without merit and intends to vigorously defend against it.

In all cases, at each reporting period, the Company evaluates whether or not 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 and results of operations.

## Note 8—Stock-Based Compensation

### 1999 Stock Plan

In September 1999, the Company adopted the 1999 Stock Plan (the "1999 Plan"). Under the 1999 Plan, the Company issued shares of common stock and options to purchase common stock to employees, directors and consultants. Options granted under the Plan were incentive stock options or non-qualified stock options. Incentive stock options ("ISO") were granted only to Company employees, which includes officers and directors of the Company. Non-qualified stock options ("NSO") and stock purchase rights were able to be granted to employees and consultants. Options under the Plan were to be granted at prices not less than 85% of the deemed fair value of the shares on the date of the grant as determined by the Company's Board of Directors ("the Board"), provided, however, that (i) the exercise price of an ISO and NSO was not less than 100% and 85% of the deemed fair value of the shares on the date of grant, respectively, and (ii) the exercise price of an ISO and NSO granted to a 10% stockholder was not less than 110% of the deemed fair value of the shares on the date of grant. The Board determined the period over which options became exercisable. The term of the options was to be no longer than five years for ISOs for which the grantee owns greater than 10% of the voting power of all classes of stock and no longer than ten years for all other options. Options granted under the 1999 Plan generally vested over four years. The Board of Directors determined that no further grants of awards under the 1999 Plan would be made after the Company's IPO.

### 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 10 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 to increase the number of shares available for issuance by 1,300,000 shares.

## Stock Option Activity

A summary of the Company's stock option activity at December 31, 2017 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 |
|---|---|---|---|---|
| Balances, December 31, 2016 | 950 | $ 46.58 | | |
| Granted | 614 | 45.68 | | |
| Exercised | (32) | 21.51 | | |
| Forfeited, canceled or expired | (3) | 33.97 | | |
| **BALANCES, DECEMBER 31, 2017** | **1,529** | **$46.77** | **5.6** | **$4,632** |
| **OPTIONS VESTED AND EXPECTED TO VEST AS OF DECEMBER 31, 2017** | **1,347** | **$46.75** | **5.6** | **$4,113** |
| **OPTIONS VESTED AS OF DECEMBER 31, 2017** | **401** | **$46.48** | **5.0** | **$1,385** |

As of December 31, 2016, and 2015, there were 100,000 and 198,000 options vested, respectively.

During the year ended December 31, 2017, the Company granted options to purchase an aggregate of 614,000 shares of common stock at a weighted average exercise price of $45.68, with an estimated weighted-average grant-date fair value of $12.23. The total intrinsic value of options exercised during the years ended December 31, 2017, 2016 and 2015 was $0.9 million, $2.8 million, and $4.1 million, respectively. Net cash proceeds from the exercise of stock options were $0.7 million, $2.1 million, and $3.2 million for the years ended December 31, 2017, 2016 and 2015. The total grant date fair value of stock options vested during the years ended December 31, 2017, 2016 and 2015 was $4.5 million, $0.1 million, and $0.5 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 Company did not grant stock options in 2015. The assumptions used to value options granted during the years ended December 31, 2017 and 2016 are as follows (there were no option awards granted during the year ended December 31, 2015):

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| Dividend yield | — | — |
| Annual risk-free rate of return | 1.9% | 1.2% |
| Expected volatility | 29.8% | 32.9% |
| Expected term (years) | 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 is amortized on a straight-line basis over the requisite service period.

## Restricted Stock Unit Activity

A summary of the Company's restricted stock unit activity for the year ended December 31, 2017, is as follows (share numbers in thousands):

| | NUMBER OF UNITS OUTSTANDING | WEIGHTED AVERAGE GRANT DATE FAIR VALUE |
|---|---|---|
| Awarded and unvested, December 31, 2016 | 2,834 | $ 43.52 |
| Granted | 821 | 47.21 |
| Vested | (954) | 43.91 |
| Forfeited | (408) | 43.78 |
| **AWARDED AND UNVESTED AS OF DECEMBER 31, 2017** | **2,293** | **$44.64** |
| **RESTRICTED STOCK UNITS EXPECTED TO VEST AS OF DECEMBER 31, 2017** | **1,954** | |

The chart below summarizes grant activity during the year ended December 31, 2017 by equity plan (share numbers in thousands):

| | GRANTS IN 2017 |
|---|---|
| **2015 EQUITY INCENTIVE PLAN** | |
| Stock options(1) | 540 |
| Restricted stock units(1) | 773 |
| **TOTAL GRANTS UNDER 2015 PLAN** | **1,313** |
| **INDUCEMENT SHARES** | |
| Stock options(2) | 74 |
| Restricted stock units(2) | 48 |
| **TOTAL GRANTS PURSUANT TO INDUCEMENT SHARES** | **122** |
| **TOTAL AWARDS GRANTED IN 2017** | **1,435** |

(1) Awards issued under the 2015 Plan include stock options and restricted stock unit awards granted to new and current employees. Awards issued under this plan typically vest over a four-year total vesting term.

(2) Inducement awards are issued to newly hired officers and to certain new employees from acquired companies. During 2017, inducement awards included time-based awards and options issued to a newly hired officer.

During the years ended December 31, 2017, 2016, and 2015, the fair value of awards vested were $41.9 million, $56.7 million, and $64.5 million respectively.

At December 31, 2017, the Company had $69.4 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.

## Note 9—Income Taxes

Income (loss) before income taxes is as follows (in thousands):

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| United States | $ 35,213 | $ 26,440 | $ (2,303) |
| Foreign | 32 | 148 | 314 |
| **TOTAL** | **$35,245** | **$26,588** | **$(1,989)** |

The components of the provision for (benefit from) income taxes are as follows (in thousands):

| | DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **FEDERAL:** | | | |
| Current | $ 912 | $ 837 | $ (23) |
| Deferred | (2,884) | 7,306 | (2,053) |
| | (1,972) | 8,143 | (2,076) |
| **STATE:** | | | |
| Current | 3,937 | 188 | 768 |
| Deferred | 3,050 | 1,895 | 91 |
| | 6,987 | 2,083 | 859 |
| **FOREIGN:** | | | |
| Current | 472 | 758 | 258 |
| Deferred | (327) | (302) | (187) |
| | 145 | 456 | 71 |
| **TOTAL INCOME TAX EXPENSE (BENEFIT):** | | | |
| Current | 5,321 | 1,783 | 1,003 |
| Deferred | (161) | 8,899 | (2,149) |
| | **$5,160** | **$10,682** | **$(1,146)** |

The Company's actual tax expense differed from the statutory federal income tax rate, as follows:

| | DECEMBER 31, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| Income tax expense at statutory rate | 35.0% | 35.0% | 35.0% |
| State income taxes | 0.8 | (2.8) | 142.6 |
| Stock-based compensation | (3.2) | (0.4) | 8.9 |
| R&D tax credit | (4.3) | (6.6) | 173.5 |
| Non-deductible executive compensation | 5.4 | 4.7 | (116.5) |
| Valuation allowance | 6.4 | 7.4 | (170.7) |
| Uncertain tax benefit liability settlement | — | 1.4 | — |
| Tax reform | (25.2) | — | — |
| Other | (0.3) | 1.5 | (15.3) |
| | **14.6%** | **40.2%** | **57.5%** |

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (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 is effective January 1, 2018. The Company has determined that the Tax Act requires a revaluation of its net deferred tax asset upon its enactment during the current quarter. Deferred tax assets and liabilities are measured using the enacted tax rate expected to apply to taxable income in years in which those temporary differences are expected to be recovered or settled. As changes in tax laws or rates are enacted, like the Tax Act, deferred tax assets and liabilities are adjusted through income tax expense during the fourth quarter of 2017.

Subsequent to the enactment of the Act, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 ("SAB 118"), which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides 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"). In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the Tax Act.

Since the Tax Act was passed late in the fourth quarter of 2017, and ongoing guidance and accounting interpretation are expected over the next 12 months, the Company considers the accounting of the deferred tax re-measurements and other items to be provisional due to the forthcoming guidance and the Company's ongoing analysis of final year-end data and tax positions. The Company expects to complete its analysis within the measurement period in accordance with SAB 118.

At December 31, 2017 the Company had approximately $0.7 million and $23.5 million of Federal and California net operating loss carryforwards, respectively. None of these net operating loss carryforwards are associated with windfall tax benefits for federal and state income tax purposes. Effective January 1, 2017, the Company adopted ASU 2016-09 resulting in excess tax benefits or tax deficiencies from stock-based compensation being recorded to the consolidated statement of income within the provision for income taxes rather than in the consolidated balance sheet within additional paid-in capital. These carryforwards will expire beginning in the year 2023 and 2031 for federal and California purposes, respectively.

The Company also had research and development credit carryforwards of approximately $12.5 million and $16.5 million for federal and state income tax purposes, respectively, at December 31, 2017. None of these are associated with windfall tax benefits for federal and state income tax purposes due to adoption of ASU 2016-09. 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 expire starting in 2021 for federal and 2024 for Arizona.

The Internal Revenue Code ("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, 2017 and 2016 are as follows (in thousands):

| | December 31, | |
|---|---|---|
| | **2017** | **2016** |
| **DEFERRED TAX ASSETS:** | | |
| Net operating loss carryforwards | $ 1,837 | $ 460 |
| Reserves and other tax benefits | 33,145 | 50,178 |
| Tax credits | 32,057 | 17,149 |
| **DEFERRED TAX ASSETS** | **67,039** | **67,787** |
| Valuation allowance | (17,111) | (9,998) |
| **NET DEFERRED TAX ASSETS** | **49,928** | **57,789** |
| **DEFERRED TAX LIABILITIES:** | | |
| Depreciation and amortization | (47,293) | (77,455) |
| **NET DEFERRED TAX ASSETS (LIABILITIES)** | **$ 2,635** | **$(19,666)** |

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 $17.1 million as of December 31, 2017 and $10.0 million as of December 31, 2016. 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, 2017. 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, 2017. Accordingly, with exception of the valuation allowance discussed above, no additional valuation allowance has been recorded on this net asset as of December 31, 2017. The Company will continue to assess the need for a valuation allowance in the future.

As of December 31, 2017, the Company had $9.0 million of unrecognized tax benefits. A reconciliation of the beginning and ending amounts of unrecognized income tax benefits is as follows (in thousands):

| | **2017** | **2016** | **2015** |
|---|---|---|---|
| Balance of unrecognized tax benefits at January 1 | $ 6,586 | $ 5,703 | $ 8,566 |
| Additions for tax positions of prior years | 1,393 | — | — |
| Additions for tax positions related to current year | 1,050 | 951 | 1,050 |
| Reductions for tax positions of prior years | — | (68) | (3,913) |
| **BALANCE OF UNRECOGNIZED TAX BENEFITS AT DECEMBER 31** | **$9,029** | **$6,586** | **$5,703** |

If the $9.0 million of unrecognized tax benefits as of December 31, 2017 is recognized, approximately $4.5 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 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 amounts accrued for interest and penalties related to tax uncertainties were not significant for the year ended December 31, 2017. No amounts were accrued for the year ended December 31, 2016.

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, 2017, the Company is subject to taxation in the United States and Israel. The Company is subject to examination for tax years including and after 2014 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 10—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 2017, 2016 and 2015, there were no discretionary contributions.

## Note 11—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, 2017, the Company's Board of Directors has 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.

We suspended the Company's share repurchase program as of December 31, 2017 and we have publicly committed to de-levering.

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 2015, 2016, and 2017:

| PERIOD(1) | TOTAL NUMBER OF SHARES PURCHASED | AVERAGE PRICE PAID PER SHARE | TOTAL DOLLAR VALUE SPENT ON REPURCHASES (IN THOUSANDS) |
|---|---|---|---|
| 2015 Repurchases(2) | 4,907,675 | $43.99 | $215,911 |
| 2016 Repurchases | 2,524,752 | $44.55 | $112,488 |
| 2017 Repurchases | 2,325,825 | $47.29 | $110,000 |

(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.

(2) The Company entered into an accelerated share repurchase ("ASR") in the second quarter of 2015 under which a prepayment of $75.0 million was made. Final settlement of the ASR occurred on August 3, 2015, resulting in the delivery to the Company of 0.8 million shares of the Company's common stock and a return of cash for the remaining amount not settled in shares of $38.2 million. In total, approximately 0.8 million shares of common stock were repurchased under the ASR for $36.8 million, resulting in an average price paid per share of $46.49 under the ASR.

## Note 12—Debt

### Syndicated Credit Facilities

### 2017 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 ("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.

On October 18, 2017, the Company fully drew the $300.0 million Term Loan under the Credit Agreement. The full amount of the $200.0 million Revolving Loan Facility remains undrawn as of December 31, 2017. The proceeds of the Term Loan will be used (1) to settle the Company's existing 0.25% Convertible Senior Notes due May 15, 2018 and (2) for working capital and general corporate purposes.

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. 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.

The Term Loan has a maturity date of August 17, 2024. Commencing on the last day of the first full fiscal quarter following the Company's borrowing of the Term Loan, the Term loan will amortize in equal quarterly installments of 0.25% of the original principal, with the remaining principal balance 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 and a 1.0% repricing premium applicable during the first six months for the Term Loan. 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, 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, 2017, the Company is in compliance with these 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 secured delayed draw Term Loan so that the interest payable on such portion become fixed (refer to *Note 6—Derivative Financial Instruments* for further details regarding the interest-rate swap agreements).

The Company incurred $5.6 million in credit facility origination costs during the year ended December 31, 2017 related to the Credit Agreement. 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 Term Loan are presented as a reduction to the carrying value of the debt in the consolidated balance sheet. Fees attributable to the Revolving Loan Facility are being amortized over five years and fees attributable to the Term Loan are being amortized over seven years, both as a component of interest expense.

The Term Loan consist of the following (in thousands):

| | DECEMBER 31, 2017 |
|---|---|
| **LIABILITY COMPONENT:** | |
| Principal | $ 300,000 |
| Less: debt issuance costs, net of amortization | (4,543) |
| **NET CARRYING AMOUNT** | **$295,457** |
| Term loan, current | $ 3,000 |
| **TERM LOAN, NON-CURRENT** | **$292,457** |

The following table sets forth the total interest expense recognized related to the Term Loan during fiscal 2017 (in thousands):

| | |
|---|---|
| Floating interest (including the effects of cash flow hedges) | $ 2,505 |
| Amortization of debt issuance costs | 247 |
| Delayed draw ticking fees | 551 |
| | **$3,303** |

## Existing Facility

On August 17, 2017, in connection with the Company's entry into the new Credit Agreement, the Company terminated its existing credit agreement, dated as of November 22, 2011, as amended as of May 10, 2013, and as further amended and restated as of June 10, 2016 (the "Existing Credit Agreement").

### 0.25% Convertible Senior Notes Due May 15, 2018

In May 2013, the Company issued $300.0 million aggregate principal amount of 0.25% convertible senior notes (the "Notes") due May 15, 2018, unless earlier purchased by the Company or converted. Interest is payable semiannually in arrears on May 15 and November 15 of each year, commencing on November 15, 2013.

The Notes are governed by an Indenture between the Company, as issuer, and Wells Fargo Bank, National Association, as trustee. The Notes are unsecured and rank senior in right of payment to the Company's future indebtedness that is expressly subordinated in right of payment to the Notes and rank equal in right of payment to the Company's existing and future liabilities that are not so subordinated and are effectively subordinated in right of payment to any of the Company's cash equal to the principal amount of the Notes, and secured indebtedness to the extent of the value of the assets securing such indebtedness and are structurally subordinated to all existing and future indebtedness and liabilities incurred by the Company's subsidiaries.

Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of common stock, at the Company's election.

The initial conversion rate is 15.5847 shares of common stock per $1,000 principal amount of Notes. The initial conversion price is $64.17 per share of common stock. Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Accrued but unpaid interest will be deemed to be paid in full upon conversion rather than cancelled, extinguished or forfeited. Holders may convert their Notes only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on September 30, 2013 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any ten consecutive trading day period (the "Notes Measurement Period") in which the "trading price" (as the term is defined in the Indenture) per $1,000 principal amount of notes for each trading day of such Notes Measurement Period was less than 98% of the product of the last reported sale price of the Company's common stock on such trading day and the conversion rate on each such trading day;
- upon the occurrence of specified corporate events; or
- at any time on or after December 15, 2017 until the close of business on the second scheduled trading immediately preceding the maturity date.

As of December 31, 2017, the Notes are convertible. During the second quarter of 2017, the Notes were reclassified from long-term liabilities to current as these are now within one year of maturity.

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, are being 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. The unamortized issuance costs balance attributable to the liability component was $0.5 million as of December 31, 2017. Additionally, the Company recorded a deferred tax asset of $0.6 million on a portion of the equity component transaction costs which are deductible for tax purposes.

Concurrently with the Note issuance, the Company repurchased 0.6 million shares of common stock for approximately $30.0 million.

The Notes consist of the following (in thousands):

| | DECEMBER 31, 2017 | DECEMBER 31, 2016 |
|---|---|---|
| **LIABILITY COMPONENT:** | | |
| Principal | $ 300,000 | $ 300,000 |
| Less: debt issuance costs, debt discount, net of amortization | (5,946) | (21,208) |
| **NET CARRYING AMOUNT (CLASSIFIED AS CURRENT)** | **$294,054** | **$278,792** |
| **Equity component(1)** | **$ 63,510** | **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, | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| 0.25% coupon | $ 750 | $ 750 | $ 750 |
| Amortization of debt issuance costs | 1,395 | 1,319 | 1,247 |
| Amortization of debt discount | 13,866 | 13,113 | 12,400 |
| | **$16,011** | **$15,182** | **$14,397** |

## 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 will expire upon maturity of the Notes. The Note Hedge is 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.

## 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. If the average market value per share of the Company's common stock for the reporting period, as measured under the Warrant, exceeds the strike price of the Warrant, the Warrant will have a dilutive effect on the Company's earnings per share. The Warrant is a separate transaction, entered into by the Company and is not part of the Notes or the Note Hedge, and has been accounted for as part of additional paid-in capital. Holders of the Notes and Note Hedge will not have any rights with respect to the Warrant.

## Note 13—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.

The Chief Operating Decision Maker ("CODM") function uses gross profit to evaluate the performance of the segments and allocate resources. Management considers gross 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. Cost of net revenues for the Consumer segment consists of costs incurred to produce personalized products for all of the Company's 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 revenues also includes amortization of capitalized website and software development costs, primarily related to adding features and functionality to the Company's 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 revenues also includes inventory markdowns that are part of restructuring activities. Cost of net revenues 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 and costs associated with third-party production of goods. They also include shipping costs and indirect overhead.

Due to the nature of the Company's operations, a majority of its assets are utilized across all segments. In addition, 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.

The Company's segments are determined based on the products and services it provides and how the CODM evaluates the business. The Company has the following reportable segments:

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, home décor, personalized gifts, high quality prints, and other photo-based merchandise, and related shipping revenues, as well as rental revenue from its BorrowLenses brand. Revenue from advertising displayed on the Company's websites is also included in Consumer revenues.

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.

In addition to the above reportable segments, the Company has a corporate category that includes activities that are not directly attributable or allocable to a specific segment. This category consists of stock-based compensation expense and amortization of intangible assets.

The Company's segment results for fiscal 2017, 2016 and 2015 were as follows (dollars in thousands):

| | YEAR ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 2017 | 2016 | 2015 |
| **CONSUMER** | | | |
| Net revenues | $ 996,963 | $ 997,556 | $ 961,418 |
| Cost of net revenues | 456,665 | 455,387 | 436,050 |
| Restructuring | 1,475 | — | — |
| **GROSS PROFIT** | **$ 538,823** | **$ 542,169** | **$ 525,368** |
| Gross profit as a percentage of net revenues | 54% | 54% | 55% |
| **SHUTTERFLY BUSINESS SOLUTIONS (SBS)** | | | |
| Net revenues | $ 193,239 | $ 136,668 | $ 98,011 |
| Cost of net revenues | 154,068 | 100,582 | 79,789 |
| **GROSS PROFIT** | **$ 39,171** | **$ 36,086** | **$ 18,222** |
| Gross profit as a percentage of net revenues | 20% | 26% | 19% |
| **CORPORATE** | | | |
| Net revenues | $ — | $ — | $ — |
| Cost of net revenues | 8,917 | 10,148 | 12,239 |
| **GROSS PROFIT** | **$ (8,917)** | **$ (10,148)** | **$ (12,239)** |
| **CONSOLIDATED** | | | |
| Net revenues | $1,190,202 | $1,134,224 | $1,059,429 |
| Cost of net revenues | 619,650 | 566,117 | 528,078 |
| Restructuring | 1,475 | — | — |
| **GROSS PROFIT** | **$ 569,077** | **$ 568,107** | **$ 531,351** |
| Gross profit as a percentage of net revenues | 48% | 50% | 50% |

## Note 14—Restructuring

### 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 part of the plan, the following actions were taken:

- During the second quarter of 2017, the Company shut down the legacy Tiny Prints website and reinvested in Tiny Prints as its premium cards & stationery brand, creating a Tiny Prints boutique on a dedicated tab on Shutterfly.com;
- During the second quarter, the MyPublisher brand was retired in favor of the industry-leading Shutterfly Photo Books category; and
- During the third quarter of 2017, the Company launched the new Shutterfly Wedding Shop and shut down the Wedding Paper Divas legacy website

As of December 31, 2017, the Company has substantially completed all actions under the 2017 Restructuring Plan. The Tiny Prints, MyPublisher and Wedding Paper Divas legacy websites were shut down during the first nine months of fiscal 2017. The Company seeks to retain as many customers and as much revenue as possible while migrating 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 revenues and operating expenses in the consolidated statement of operations during the year ended December 31, 2017.

### 2015 Restructuring Plan

During 2015, the Company decided to discontinue the Treat brand as well as close the manufacturing operations in Elmsford, New York as part of the Company’s strategic initiatives (“2015 Restructuring Plan”). Actions pursuant to the 2015 Restructuring Plan were substantially complete as of the first quarter of 2016. Total restructuring costs associated with the 2015 Restructuring Plan were $0.3 million and $3.5 million during the year ended December 31, 2016 and December 31, 2015, respectively. The restructuring expenses incurred during the year ended December 31, 2015 were recorded within the cost of net revenues line item in the amount of $2.7 million and technology and development line item in the amount of $0.8 million in the consolidated statement of operations.

## Restructuring Activity

The following table summarizes the restructuring costs recognized during the years ended December 31, 2017, 2016, and 2015 (in thousands):

| | 2017 RESTRUCTURING | | | | 2015 RESTRUCTURING | | |
|---|---|---|---|---|---|---|---|
| | PROPERTY AND EQUIPMENT | EMPLOYEE COSTS | INVENTORY | OTHER COSTS | EMPLOYEE COSTS | OTHER COSTS | TOTAL |
| Balance as of January 1, 2015 | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Restructuring and other charges | — | — | — | — | 1,043 | 2,494 | 3,537 |
| Cash payments | — | — | — | — | (577) | — | (577) |
| Non-cash adjustments[2] | — | — | — | — | — | (435) | (435) |
| **BALANCES AS OF DECEMBER 31, 2015[1]** | **—** | **—** | **—** | **—** | **466** | **2,059** | **2,525** |
| Restructuring and other charges | — | — | — | — | 61 | 229 | 290 |
| Cash payments | — | — | — | — | (527) | (686) | (1,213) |
| **BALANCE AS OF DECEMBER 31, 2016[1]** | **—** | **—** | **—** | **—** | **—** | **1,602** | **1,602** |
| Restructuring and other charges | 8,233 | 5,851 | 1,475 | 1,226 | — | 181 | 16,966 |
| Cash payments | (250) | (4,658) | — | (786) | — | (390) | (6,084) |
| Non-cash adjustments[2] | (6,933) | (814) | (1,475) | (23) | — | — | (9,245) |
| **BALANCE AS OF DECEMBER 31, 2017[1]** | **$1,050** | **$ 379** | **$ —** | **$ 417** | **$ —** | **$1,393** | **$ 3,239** |

[1] The balances as of December 31, 2017, 2016, and 2015 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 15—Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for the years ended December 31, 2017 and 2016 are as follows (in thousands, except per share amounts):

| | YEAR ENDED DECEMBER 31, 2017 | | | |
|---|---|---|---|---|
| | FIRST QUARTER | SECOND QUARTER | THIRD QUARTER | FOURTH QUARTER |
| Net revenues | $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 |

| | YEAR ENDED DECEMBER 31, 2016 | | | |
|---|---|---|---|---|
| | FIRST QUARTER | SECOND QUARTER | THIRD QUARTER | FOURTH QUARTER |
| Net revenues | $181,709 | $203,961 | $187,328 | $561,226 |
| Gross profit | $ 72,986 | $ 94,369 | $ 69,574 | $331,178 |
| Net income (loss) | $ (29,436) | $ (16,485) | $ (29,155) | $ 90,982 |
| Net income (loss) per common share: | | | | |
| Basic | $ (0.85) | $ (0.48) | $ (0.86) | $ 2.70 |
| Diluted | $ (0.85) | $ (0.48) | $ (0.86) | $ 2.63 |

## Note 16—Subsequent Event

On January 30, 2018, the Company entered into a Stock Purchase Agreement (the "Purchase Agreement") with Lifetouch, Inc. ("Lifetouch") and Lifetouch Inc. Employee Stock Ownership Trust (the "Seller"), pursuant to which the Company will acquire 100% of the issued and outstanding shares of common stock of Lifetouch from the Seller. The consummation of the acquisition is subject to customary closing conditions, including regulatory approval among other conditions. Under the terms of the Purchase Agreement, the consideration for the acquisition will consist of an all-cash purchase price of $825.0 million subject to certain post-closing adjustments based on a determination of closing net working capital, transaction expenses, cash and indebtedness. The Company expects to close the acquisition in the second quarter of 2018 and will finance the all-cash purchase price with an incremental $825.0 million term loan issuance. In connection with the Purchase Agreement, the Company entered into a commitment letter (the "Commitment Letter"), dated as of January 30, 2018, with Morgan Stanley Senior Funding, Inc. ("Morgan Stanley"), pursuant to which Morgan Stanley has committed to provide a secured incremental term loan facility in an aggregate amount of $825.0 million under the Company's existing Credit Agreement. Issuance of the secured incremental term loan is subject to various conditions, including the execution of the definitive documentation and other customary closing conditions.

Lifetouch provides the Company with a highly complementary business. The Company expects to gain access to many Lifetouch customers as Shutterfly customers, where they will benefit from Shutterfly's leading cloud-photo management service, product creation capabilities, mobile apps, and broad product range. Lifetouch will be able to 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 also expects to realize significant supply chain, manufacturing, and fulfillment synergies over time.

## Schedule II
## Valuation and Qualifying Accounts

| | BALANCE AT BEGINNING OF PERIOD | ADDITIONS: CHARGED TO COSTS AND EXPENSES | ADDITIONS: CHARGED TO OTHER ACCOUNTS | DEDUCTIONS | BALANCE AT END OF PERIOD |
|---|---|---|---|---|---|
| | | | In thousands | | |
| **ALLOWANCE FOR DOUBTFUL ACCOUNTS RECEIVABLE** | | | | | |
| Year ended December 31, 2015 | $ 1 | 37 | — | (28) | $ 10 |
| Year ended December 31, 2016 | $ 10 | 45 | — | (20) | $ 35 |
| Year ended December 31, 2017 | $ 35 | — | — | (35) | $ — |
| **TAX VALUATION ALLOWANCE** | | | | | |
| Year ended December 31, 2015 | $4,850 | 3,394 | — | (83) | $ 8,161 |
| 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 |

## 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, 2017. 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, 2017, 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.

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, 2017.

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, 2017 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, 2017 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 “Information Regarding the Board of Directors and its Committees.”

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 “Information Regarding the Board of Directors and its 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 Committee Interlocks and Insider Participation,” and “Compensation Committee Report.”

## 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 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 FORM | FILE NO. | DATE OF FIRST FILING | EXHIBIT NUMBER | PROVIDED HEREWITH |
|---|---|---|---|---|---|---|
| 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 | 1999 Stock Plan and forms of stock option agreement and a stock option exercise agreement.* | S-1 | 333-135426 | June 29, 2006 | 10.02 | |
| 10.03 | 2006 Equity Incentive Plan, as amended.* | 10-Q | 001-33031 | November 5, 2013 | 10.01 | |
| 10.04 | 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 | |
| 10.05 | Form of Inducement Restricted Stock Unit Award Agreement.* | 10-K | 001-33031 | February 14, 2013 | 10.04 | |
| 10.06 | 2015 Equity Incentive Plan.* | DEF 14A | 001-33031 | November 18, 2015 | Appendix A | |
| 10.07 | 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 | |
| 10.08 | Shutterfly, Inc. 2015 CEO Compensation Plan. (as amended May 22, 2015).* | 10-Q | 001-33031 | August 6, 2015 | 10.01 | |
| 10.09 | Shutterfly, Inc. 2015 Quarterly Bonus Plan (CEO & eStaff).* | 10-Q | 001-33031 | May 7, 2015 | 10.02 | |
| 10.10 | Shutterfly, Inc. Executive Stock Ownership Guidelines, as amended.* | 10-Q | 001-33031 | May 3, 2012 | 10.02 | |
| 10.11 | Offer letter dated January 17, 2007 for Dwayne Black.* | 10-K | 001-33031 | March 20, 2007 | 10.15 | |
| 10.12 | Amendment to Offer Letter dated December 23, 2008 for Dwayne Black.* | 10-K | 001-33031 | February 24, 2009 | 10.20 | |
| 10.13 | Offer Letter dated March 5, 2012 for John Boris.* | 10-Q | 001-33031 | May 7, 2013 | 10.02 | |
| 10.14 | Offer Letter dated October 9, 2014 for Satish Menon.* | 10-K | 001-33031 | February 18, 2015 | 10.18 | |
| 10.15 | Letter Agreement, dated May 14, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Base Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.01 | |

| EXHIBIT NUMBER | EXHIBIT DESCRIPTION | INCORPORATED BY REFERENCE FORM | FILE NO. | DATE OF FIRST FILING | EXHIBIT NUMBER | PROVIDED HEREWITH |
|---|---|---|---|---|---|---|
| 10.16 | Letter Agreement, dated May 14, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Base Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.02 | |
| 10.17 | Letter Agreement, dated May 14, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Base Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.03 | |
| 10.18 | Letter Agreement, dated May 14, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Base Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.04 | |
| 10.19 | Letter Agreement, dated May 14, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Base Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.05 | |
| 10.20 | Letter Agreement, dated May 14, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Base Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.06 | |
| 10.21 | Letter Agreement, dated May 14, 2013, between Bank of America, N.A. and Shutterfly, Inc. regarding the Base Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.07 | |
| 10.22 | Letter Agreement, dated May 14, 2013 between Bank of America, N.A. and Shutterfly, Inc. regarding the Base Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.08 | |
| 10.23 | Letter Agreement, dated May 15, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Additional Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.09 | |
| 10.24 | Letter Agreement, dated May 15, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Additional Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.10 | |
| 10.25 | Letter Agreement, dated May 15, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Additional Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.11 | |
| 10.26 | Letter Agreement, dated May 15, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Additional Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.12 | |
| 10.27 | Letter Agreement, dated May 15, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Additional Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.13 | |
| 10.28 | Letter Agreement, dated May 15, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Additional Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.14 | |
| 10.29 | Letter Agreement, dated May 15, 2013, between Bank of America, N.A. and Shutterfly, Inc. regarding the Additional Warrant Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.15 | |
| 10.30 | Letter Agreement, dated May 15, 2013 between Bank of America, N.A. and Shutterfly, Inc. regarding the Additional Call Option Transaction. | 8-K | 001-33031 | May 20, 2013 | 10.16 | |

| EXHIBIT NUMBER | EXHIBIT DESCRIPTION | INCORPORATED BY REFERENCE FORM | FILE NO. | DATE OF FIRST FILING | EXHIBIT NUMBER | PROVIDED HEREWITH |
|---|---|---|---|---|---|---|
| 10.31 | Offer Letter dated October 23. 2015, by and between Shutterfly, Inc. and Mike Pope.* | 8-K | 001-33031 | October 27, 2015 | 10.1 | |
| 10.32 | Form of Executive Retention Agreement.* | 8-K | 001-33031 | December 28, 2015 | 99.1 | |
| 10.33 | Form of Executive Change in Control Agreement.* | 10-Q | 001-33031 | May 4, 2016 | 10.03 | |
| 10.34 | Form of Amendment to Executive Retention Agreement.* | 10-Q | 001-33031 | May 4, 2016 | 10.04 | |
| 10.35 | Offer Letter dated March 15, 2016, by and between Shutterfly, Inc. and Christopher North.* | 8-K | 001-33031 | March 17, 2016 | 99.1 | |
| 10.36 | 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 | |
| 10.37 | 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 | |
| 10.38 | 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 | |
| 10.39 | Form of Amended and Restated Retention Agreement.* | 8-K | 001-33031 | February 17, 2017 | 99.1 | |
| 10.40 | 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 | |
| 10.41 | 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 | |
| 10.42 | Debt Commitment Letter dated January 30, 2018 by and between Shutterfly, Inc. | 8-K | 001-33031 | January 30, 2018 | 99.1 | |
| 10.43 | Offer Letter dated January 9, 2017 for Michele Anderson.* | | | | | X |
| 10.44 | Offer Letter dated June 7, 2017 for Scott Arnold.* | | | | | 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 |

| EXHIBIT NUMBER | EXHIBIT DESCRIPTION | INCORPORATED BY REFERENCE FORM | FILE NO. | DATE OF FIRST FILING | EXHIBIT NUMBER | PROVIDED HEREWITH |
|---|---|---|---|---|---|---|
| 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, 2017, 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 not deemed "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 16, 2018

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<br>Christopher North | President, Chief Executive Officer and Director<br>*(Principal Executive Officer)* | February 16, 2018 |
| /s/ Michael Pope<br>Michael Pope | Senior Vice President and Chief Financial Officer<br>*(Principal Financial Officer)* | February 16, 2018 |
| /s/ Lisa Blackwood-Kapral<br>Lisa Blackwood-Kapral | Vice President and Chief Accounting Officer<br>*(Principal Accounting Officer)* | February 16, 2018 |
| /s/ William Lansing<br>William Lansing | Chairman of the Board of Directors and Director | February 16, 2018 |

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ Thomas D. Hughes<br>Thomas D. Hughes | Director | February 16, 2018 |
| /s/ Eva Manolis<br>Eva Manolis | Director | February 16, 2018 |
| /s/ Ann Mather<br>Ann Mather | Director | February 16, 2018 |
| /s/ Elizabeth Rafael<br>Elizabeth Rafael | Director | February 16, 2018 |
| /s/ Elizabeth Sartain<br>Elizabeth Sartain | Director | February 16, 2018 |
| /s/ H. Tayloe Stansbury<br>H. Tayloe Stansbury | Director | February 16, 2018 |
| /s/ Brian T. Swette<br>Brian T. Swette | Director | February 16, 2018 |
| /s/ Michael P. Zeisser<br>Michael P. Zeisser | Director | February 16, 2018 |

Exhibit 23.1

## CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (No. 333-173987) and Form S-8 (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. 3333-148487, No. 333-137676) of Shutterfly, Inc. of our report dated February 16, 2018 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 16, 2018

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 16, 2018

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 16, 2018

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, 2017 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 16, 2018

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, 2017 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 16, 2018

By: /s/ Michael Pope

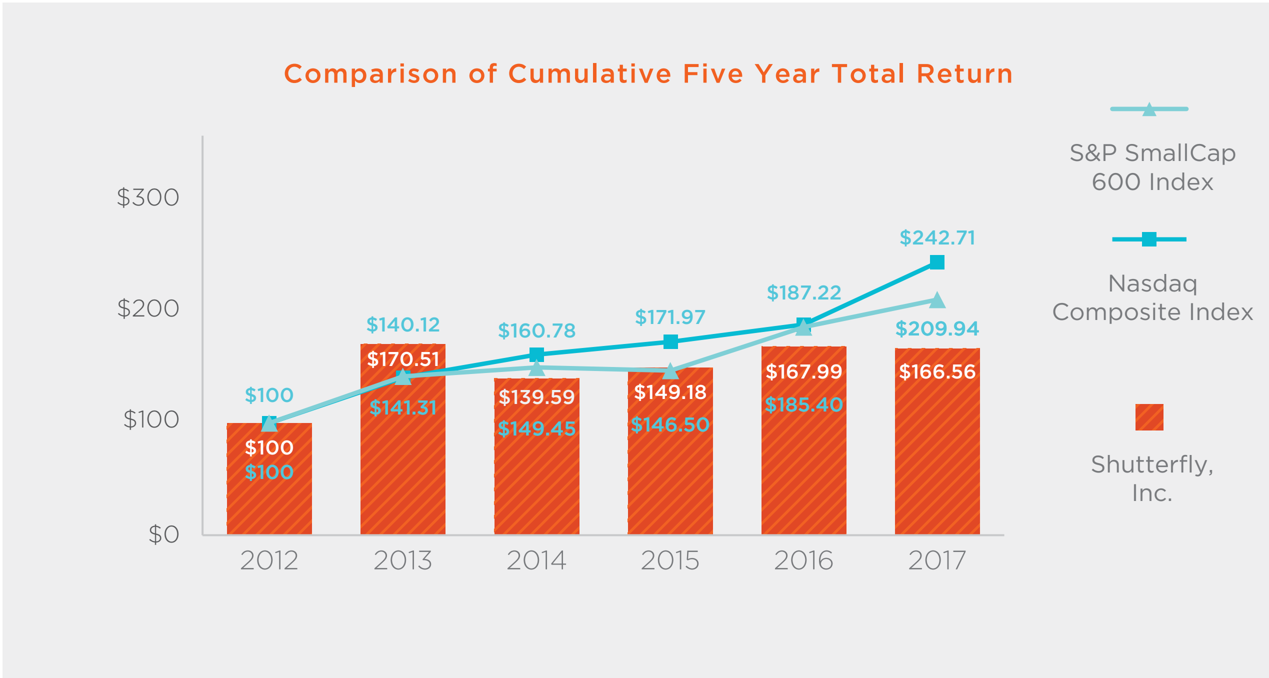
Michael Pope
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

## 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, 2012 through December 31, 2017 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, 2012 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

Shutterfly Inc., 2800 Bridge Parkway, Redwood City, CA 94065 | shutterflyinc.com