Rocket Fuel Inc.
Form 10-Q
November 14, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

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: 001-36071

ROCKET FUEL INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	30-0472319 (I.R.S. Employer Identification Number)

1900 Seaport Boulevard, Pacific Shores Center, Redwood City, CA 94063
(Address of principal executive offices and Zip Code)
(650) 595-1300
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date. On October 31, 2014, 41,295,064 shares of the registrant's common stock, par value $0.001, were outstanding.

EMERGING GROWTH COMPANY

We are an ‘‘emerging growth company’’ as that term is defined in the Jumpstart Our Business Startups Act of 2012 and, as such, we have elected to comply with certain reduced public company reporting requirements.

ROCKET FUEL INC.
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TRADEMARKS

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

Rocket Fuel Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(Unaudited)

	September 30, 2014	December 31, 2013
Assets		
Current Assets:		
Cash and cash equivalents	$111,632	$113,873
Accounts receivable, net	116,229	90,502
Deferred tax assets	1,154	207
Prepaid expenses	3,974	2,164
Other current assets	15,331	3,962
Total current assets	248,320	210,708
Property, equipment and software, net	78,217	25,794
Restricted cash	3,010	—
Intangible assets	73,525	—
Goodwill	114,871	—
Other assets	1,198	1,006
Total assets	$519,141	$237,508
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$65,284	$39,910
Accrued and other current liabilities	33,268	21,584
Deferred revenue	1,251	918
Current portion of capital leases	2,695	203
Current portion of debt	45,990	7,243
Total current liabilities	148,488	69,858
Long-term debt—Less current portion	15,965	19,568
Capital leases—Less current portion	5,024	412
Deferred rent—Less current portion	24,260	3,909
Deferred tax liabilities	2,231	207
Other liabilities	543	387
Total liabilities	196,511	94,341
Commitments and contingencies (Note 13)		
Stockholders' Equity		
Common stock, $0.001 par value— 1,000,000,000 authorized as of September 30, 2014 and December 31, 2013, respectively; 41,234,242 and 32,825,992 issued and outstanding as of September 30, 2014 and December 31, 2013, respectively	41	33
Additional paid-in capital	410,923	187,624
Accumulated other comprehensive loss	(44)	(15)
Accumulated deficit	(88,290)	(44,475)
Total stockholders' equity	322,630	143,167
Total liabilities and stockholders' equity	$519,141	$237,508

See Accompanying Notes to Condensed Consolidated Financial Statements.

Rocket Fuel Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except loss per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$102,098	$62,458	$269,137	$155,039
Cost of revenue	54,952	31,877	139,410	81,529
Gross profit	47,146	30,581	129,727	73,510
Operating expenses:				
Research and development	11,200	4,464	26,875	10,587
Sales and marketing	40,421	21,644	103,969	56,293
General and administrative	19,320	8,719	41,795	19,671
Total operating expenses	70,941	34,827	172,639	86,551
Loss from operations	(23,795)	(4,246)	(42,912)	(13,041)
Other expense, net:				
Interest expense	(1,157)	(251)	(2,085)	(604)
Other income (expense)—net	(1,999)	155	(2,443)	(213)
Change in fair value of convertible preferred stock warrant liability	—	(2,385)	—	(4,740)
Other expense, net	(3,156)	(2,481)	(4,528)	(5,557)
Loss before income taxes	(26,951)	(6,727)	(47,440)	(18,598)
Income tax benefit (provision)	4,120	(133)	3,625	(173)
Net loss	$(22,831)	$(6,860)	$(43,815)	$(18,771)
Basic and diluted net loss per share attributable to common stockholders	$(0.61)	$(0.61)	$(1.23)	$(2.01)
Basic and diluted weighted-average shares used to compute net loss per share attributable to common stockholders	37,230	11,315	35,490	9,346

See Accompanying Notes to Condensed Consolidated Financial Statements.

Rocket Fuel Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net loss	$(22,831)	$(6,860)	$(43,815)	$(18,771)
Other comprehensive income (loss): (1)				
Foreign currency translation adjustments	(54)	24	(29)	(17)
Comprehensive loss	$(22,885)	$(6,836)	$(43,844)	$(18,788)

(1) Reclassifications out of Other comprehensive income (loss) into Net loss were not significant.

See Accompanying Notes to Condensed Consolidated Financial Statements.

Rocket Fuel Inc.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014
(In thousands, except share data)
(Unaudited)

	Common Stock		Additional Paid-In	Accumulated Other Comprehensive	Accumulated	Total Stockholders'
	Shares	Amount	Capital	Income (Loss)	Deficit	Equity
Balance—January 1, 2014	32,825,992	$33	$187,624	$ (15)	$ (44,475)	$ 143,167
Issuance of common stock upon exercises of employee stock options, net of repurchases	937,733	1	3,376	—	—	3,377
Issuance of common stock upon vesting of restricted stock units	54,334	—	—	—	—	—
Shares withheld related to net share settlement of restricted stock units	(15,351)	—	(241)	—	—	(241)
Issuance of common stock in connection with acquisition	5,253,084	5	82,416	—	—	82,421
Issuance of common stock from follow-on offering, net of issuance costs	2,000,000	2	115,401	—	—	115,403
Issuance of common stock in connection with employee stock purchase plan	178,450	—	3,792	—	—	3,792
Stock-based compensation	—	—	18,376	—	—	18,376
Foreign currency translation adjustment	—	—	—	(29)	—	(29)
Tax benefit from stock-based award activity	—	—	179	—	—	179
Net loss	—	—	—	—	(43,815)	(43,815)
Balance—September 30, 2014	41,234,242	$41	$410,923	$ (44)	$ (88,290)	$ 322,630

See Accompanying Notes to Condensed Consolidated Financial Statements.

Rocket Fuel Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
OPERATING ACTIVITIES:		
Net loss	$(43,815)	$(18,771)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	12,525	4,583
Provision for doubtful accounts	62	521
Stock-based compensation	17,193	6,277
Amortization of debt discount	144	1
Excess tax benefit from stock-based activity	(179)	—
Loss (gain) on disposal of property, equipment and software	216	(26)
Change in fair value of preferred stock warrant liability	—	4,740
Changes in operating assets and liabilities:		
Accounts receivable	(5,062)	(21,236)
Prepaid expenses	(783)	(649)
Other current assets	(11,368)	(292)
Other assets	(247)	(700)
Accounts payable	13,925	12,532
Accrued and other liabilities	(1,475)	5,496
Deferred rent	20,471	100
Deferred revenue	323	264
Other liabilities	(3,894)	—
Net cash used in operating activities	(1,964)	(7,160)
INVESTING ACTIVITIES:		
Purchases of property, equipment and software	(40,286)	(5,564)
Business acquisition, net	(97,444)	—
Capitalized internal-use software development costs	(5,459)	(4,486)
Restricted cash	(2,203)	—
Net cash used in investing activities	(145,392)	(10,050)
FINANCING ACTIVITIES:		
Proceeds from the issuance of common stock in initial and follow-on public offering, net of underwriting discounts and commission	116,510	107,880
Issuance costs related to initial and follow-on public offering	(1,107)	(1,534)
Proceeds from the exercise of common stock warrants	—	97
Proceeds from exercise of vested common stock options	2,682	208
Proceeds from early exercise of unvested common stock options	17	1,058
Repurchases of common stock options early exercised	(24)	(11)
Excess tax benefit from stock-based activity	179	—
Proceeds from issuance of common stock from employee stock purchase plan	3,792	—
Tax withholdings related to net share settlements of restricted stock units	(241)	—

Repayment of capital lease obligations	(559)	—

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	Nine Months Ended September 30,	
FINANCING ACTIVITIES (cont.):	2014	2013
Borrowings from line of credit	35,000	10,000
Proceeds from issuance of long-term debt	—	10,000
Repayment of long-term debt	(11,133)	(114)
Net cash provided by financing activities	145,116	127,584
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(1)	12
CHANGE IN CASH AND CASH EQUIVALENTS	(2,241)	110,386
CASH AND CASH EQUIVALENTS—Beginning of period	113,873	14,896
CASH AND CASH EQUIVALENTS—End of period	$111,632	$125,282
SUPPLEMENTAL DISCLOSURES OF OTHER CASH FLOW INFORMATION:		
Cash paid for income taxes, net of refunds	$195	$348
Cash paid for interest	1,598	543
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Purchases of property and equipment recorded in accounts payable and accruals	$7,523	$4,952
Offering costs recorded in accrued liabilities	—	3,194
Property, plant and equipment acquired under capital lease obligations	7,855	—
Vesting of early exercised options	674	229
Stock-based compensation capitalized in internal-use software costs	1,183	437
Issuance of common stock in connection with acquisition	82,421	—
Conversion of convertible preferred stock to common stock	—	60,617
Conversion of preferred stock warrants to common stock	—	7,481

See Accompanying Notes to Condensed Consolidated Financial Statements.

ROCKET FUEL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rocket Fuel Inc. (the “Company”) was incorporated as a Delaware corporation on March 25, 2008. The Company is a provider of artificial-intelligence digital advertising solutions and is headquartered in Redwood City, California, and has offices in various cities across the United States. The Company established a wholly-owned subsidiary in the United Kingdom in 2011, in Canada in 2013, and in Brazil during the third quarter of 2014. The United Kingdom subsidiary has offices throughout Europe and in Australia and established a wholly-owned subsidiary in Germany in 2013.

In September 2013, the Company completed the initial public offering of its common stock (the “IPO”) whereby 4,000,000 shares of common stock were sold by the Company and 600,000 shares of common stock were sold by selling stockholders. The public offering price of the shares sold in the offering was $29.00 per share. The Company did not receive any proceeds from the sale of shares by the selling stockholders. The total gross proceeds from the offering to the Company were $116.0 million. After deducting underwriters’ discounts and commissions and offering expenses, the aggregate net proceeds received by the Company totaled approximately $103.3 million.

In February 2014, the Company completed an underwritten follow-on public offering (the “Follow-on Offering”) of its common stock in which 2,000,000 shares of common stock were sold by the Company and 3,000,000 shares of common stock were sold by selling stockholders. The public offering price of the shares sold in the offering was $61.00 per share. The Company did not receive any proceeds from the sale of shares by the selling stockholders. The total gross proceeds from the offering to the Company were $122.0 million. After deducting underwriters’ discounts and commissions and offering expenses, the aggregate net proceeds received by the Company totaled approximately $115.4 million.

Basis of Presentation—The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and the notes thereto for the year ended December 31, 2013, included in its Annual Report on Form 10-K.

The condensed consolidated balance sheet as of December 31, 2013 included herein was derived from the audited financial statements as of that date, but does not include all notes and other disclosures required by GAAP.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year 2014 or any future period.

Principles of Consolidation—The consolidated financial statements include the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates—The preparation of unaudited condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Such estimates include, but are not limited to, provisions for doubtful accounts, the amount of software development costs which should be capitalized, future taxable income, the useful lives of long-lived assets and the assumptions used for purposes of determining stock-based compensation. Actual results could differ from those estimates.

Foreign Currency Translation—The Company’s foreign subsidiaries record their assets, liabilities and results of operations in their local currencies, which are their functional currencies. The Company translates its subsidiaries' consolidated financial statements into U.S. dollars each reporting period for purposes of consolidation.

Assets and liabilities of the Company’s foreign subsidiaries are translated at the period-end currency exchange rates, certain equity accounts are translated at historical exchange rates and revenue, expenses, gains and losses are translated at the

average currency exchange rates in effect for the period. The effects of these translation adjustments are reported in a separate component of stockholders' equity titled accumulated other comprehensive income (loss).
Fair Value of Financial Instruments—The Company's financial instruments consist principally of cash equivalents, accounts receivable, accounts payable, accrued liabilities, capital leases, term debt and revolving credit facilities. The fair value of the Company's cash equivalents is determined based on quoted prices in active markets for identical assets for its money market funds. The recorded values of the Company's accounts receivable, accounts payable and accrued liabilities approximate their current fair values due to the relatively short-term nature of these accounts. The Company believes that the fair value of the capital leases, term debt and revolving credit facilities approximates its recorded amount as of September 30, 2014 as the interest rates on the term debt and revolving credit facilities are variable and the rates for each are based on market interest rates after consideration of default and credit risk.
Cash and Cash Equivalents—Cash consists of cash maintained in checking and savings accounts. All highly liquid investments purchased with an original maturity date of 90 days or less at the date of purchase are considered to be cash equivalents. Cash equivalents consist of money market funds.
Restricted Cash—Restricted cash as of September 30, 2014 consists of cash required to be deposited with financial institutions for security deposits for some of the Company's office lease agreements.
Concentration of Credit Risk—Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and accounts receivable. A significant portion of the Company's cash is held at three major financial institutions that the Company's management has assessed to be of high credit quality. The Company has not experienced any losses in such accounts.
The Company mitigates its credit risk with respect to accounts receivable by performing credit evaluations and monitoring agencies' and advertisers' accounts receivable balances. As of September 30, 2014, three agency holding companies and no single advertiser accounted for 10% of more of accounts receivable. As of December 31, 2013, no single agency holding company or advertiser accounted for 10% or more of accounts receivable.
With respect to revenue concentration, the Company defines a customer as an advertiser that is a distinct source of revenue and is legally bound to pay for the advertising services that the Company delivers on the advertiser's behalf. The Company counts all advertisers within a single corporate structure as one customer even in cases where multiple brands, branches or divisions of an organization enter into separate contracts with the Company. During the three and nine months ended September 30, 2014 and 2013, no single customer represented 10% or more of revenue.

The Company also monitors the percentage of revenue that flows through advertising agencies, even though advertising agencies that act on behalf of the Company's advertisers are not considered customers based on the definition above. If all branches and divisions within each global advertising agency were considered to be a single agency for this purpose, three agency holding companies would have been associated with 10% or more of revenue during the three and nine months ended September 30, 2014, and two agency holding companies would have been associated with 10% or more of revenue during the three and nine months ended September 30, 2013.

Provision for Doubtful Accounts—The Company records a provision for doubtful accounts based on historical experience and a detailed assessment of the collectability of its accounts receivable. In estimating the allowance for doubtful accounts, management considers, among other factors, the aging of the accounts receivable, historical write-offs and the credit-worthiness of each customer. If circumstances change, such as higher-than-expected defaults or an unexpected material adverse change in a major customer's ability to meet its financial obligations, the Company's estimate of the recoverability of the amounts due could be reduced by a material amount.
The following table presents the changes in the allowance for doubtful accounts (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Allowance for doubtful accounts:				
Balance, beginning of period	$797	$485	$1,057	$468
Add: bad debt expense	53	505	254	521
Less: write-offs, net of recoveries	271	18	(190)	19
Balance, end of period	$1,121	$1,008	$1,121	$1,008

Property and Equipment—Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the related assets. Maintenance and repairs are charged to expense as incurred, and improvements and betterments are capitalized. When assets are retired or otherwise disposed of, the cost and accumulated depreciation or amortization, as applicable, are removed from the balance sheet and any resulting gain or loss is reflected in operations in the period realized. Construction in progress primarily includes costs related to the leasehold improvements and also includes network equipment infrastructure to support the Company's data centers around the world. Interest capitalized during the periods presented was not material.

Leasehold improvements are amortized on a straight-line basis over the term of the lease, or the useful life of the assets, whichever is shorter. Depreciation and amortization periods for the Company’s property and equipment are as follows:

Asset Classification	Estimated Useful Life
Computer hardware and purchased software	2–3 years
Capitalized internal-use software costs	2–3 years
Office equipment, furniture and fixtures	5 years

Internal-Use Software Development Costs—The Company incurs costs to develop software for internal use. The Company expenses all costs that relate to the planning and post implementation phases of development as research and development expense. The Company capitalizes costs when preliminary efforts are successfully completed, management has authorized and committed project funding, and it is probable that the project will be completed and will be used as intended. Costs incurred for enhancements that are expected to result in additional material functionality are capitalized. The Company capitalized $2.3 million and $1.7 million in internal-use software costs during the three months ended September 30, 2014 and 2013, respectively, and $6.6 million and $4.9 million for the nine months ended September 30, 2014 and 2013, respectively. These capitalized amounts are included in property, equipment and software—net on the condensed consolidated balance sheets.

Amortization commences when the website or software for internal use is ready for its intended use and the amortization period is the estimated useful life of the related asset. Amortization expense totaled $1.4 million and $0.9 million for the three months ended September 30, 2014 and 2013, respectively, and $3.7 million and $2.5 million for the nine months ended September 30, 2014 and 2013, respectively.

Impairment of Long-lived Assets—The Company periodically reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset is impaired or the estimated useful life is no longer appropriate. If indicators of impairment exist and the undiscounted projected cash flows associated with an asset are less than the carrying amount of the asset, an impairment loss is recorded to write the asset down to its estimated fair value. Fair value is estimated based on discounted future cash flows. No impairment charges were recorded during the three and nine months ended September 30, 2014 and 2013.

Business Combinations—The Company accounts for business combinations using the acquisition accounting method as required under the provisions of FASB ASC 805, Business Combinations, or ASC 805. The total purchase price is allocated to the assets acquired and liabilities assumed based on fair values at the date of acquisition. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the identifiable assets acquired and the liabilities assumed.

Best estimates and assumptions are used in the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business combination date. These estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the preliminary purchase price allocation period, which may be up to one year from the business combination date, the Company may record adjustments to the assets acquired and liabilities assumed, with the corresponding adjustment to goodwill. After the preliminary purchase price allocation period, adjustments are recorded in the operating results in the period in which the adjustments were determined.
The fair value assigned to identifiable intangible assets acquired is determined using the income approach which discounts expected future cash flows to present value using estimations and assumptions determined by management. The Company believes that these identified intangible assets will have no residual value after their estimated economic useful lives. The identifiable intangible assets are subject to amortization on a straight-line basis as this best approximates the benefit period related to these assets.
The excess of the purchase price over the identified tangible and intangible assets, less liabilities assumed, is recorded as goodwill and primarily reflects the value of the synergies expected to be generated from combining the Company's and the acquired entity’s technology and operations. Generally, the goodwill is not deductible for income tax purposes.
Goodwill, Intangibles and Impairment Assessments —Goodwill represents the excess of the aggregate purchase price paid over the fair value of the net tangible and intangible assets acquired. Intangible assets that are not considered to have an indefinite useful life are amortized over their useful lives. The Company evaluates the estimated remaining useful lives of purchased intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization.
Goodwill is not amortized and is tested for impairment at least annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company has determined that it operates as one reporting unit and has selected December 1 as the date to perform its annual impairment test.
In the impairment assessment of its goodwill, the Company performs a qualitative assessment and then, if necessary, a two step impairment test, which involves assumptions regarding estimated future cash flows to be derived from the Company. If these estimates or their related assumptions change in the future, the Company may be required to record impairment for these assets. The first step of the impairment test involves comparing the fair value of the reporting unit to its net book value, including goodwill. If the net book value exceeds its fair value, then the Company would perform the second step of the goodwill impairment test to determine the amount of the impairment loss. The impairment loss would be calculated by comparing the implied fair value of the Company to its net book value. In calculating the implied fair value of the Company’s goodwill, the fair value of the Company would be allocated to all of the other assets and liabilities based on their fair values. The excess of the fair value of the Company over the amount assigned to its other assets and liabilities is the implied fair value of goodwill. An impairment loss would be recognized when the carrying amount of goodwill exceeds its implied fair value. There has been no impairment of goodwill during the periods presented.
Revenue Recognition—To date, the Company has generated most of its revenue by delivering digital advertisements to Internet users through various channels, including display, mobile, social and video. This aspect of its business is referred to as a demand side platform, or “DSP.”
The Company recognizes revenue when all four of the following criteria are met:

- Persuasive evidence of an arrangement exists,
- Delivery has occurred or a service has been provided,
- Customer fees are fixed or determinable, and
- Collection is reasonably assured.

These revenue arrangements are generally evidenced by a fully-executed insertion order (“IO”). Generally, IOs state the number and type of advertising impressions (cost-per-thousand) to be delivered, the agreed upon rate for each delivered impression, and a fixed period of time for delivery.
The Company determines collectability by performing ongoing credit evaluations and monitoring its customers’ accounts receivable balances. For new customers and their agents, which may be advertising agencies or other third parties, the Company performs a credit check with an independent credit agency and may check credit references to determine creditworthiness. The Company only recognizes revenue when collection is reasonably assured.

In the normal course of business, the Company frequently contracts with advertising agencies on behalf of their advertiser clients. The determination of whether revenue from DSP arrangements should be reported on a gross or net basis is based on an assessment of whether the Company is acting as the principal or an agent in the transaction. In determining whether the Company acts as the principal or an agent, the Company follows the accounting guidance for principal-agent considerations. While none of the factors identified in this guidance is individually considered presumptive or determinative, because (a) the Company is the primary obligor and is responsible for (i) fulfilling the advertisement delivery, (ii) establishing the selling prices for delivery of the advertisements, (iii) selecting the media to fulfill the insertion order, and (iv) performing all billing and collection activities including retaining credit risk, and (b) the Company has the risk of fluctuating costs from its media vendors relative to fixed pricing negotiated with its customers and has discretion in selecting media vendors when fulfilling a customer's campaign, the Company has concluded that it acts as the principal in the majority of these arrangements and therefore reports revenue earned and costs incurred on a gross basis.

On occasion, the Company has offered customer incentive programs that provide rebates after achieving a specified level of advertising spending. The Company records reductions to revenue for estimated commitments related to these customer incentive programs. For transactions involving incentives, the Company recognizes revenue net of the estimated amount to be paid by rebate, provided that the rebate amount can be reasonably and reliably estimated and the other conditions for revenue recognition have been met. The Company's policy requires that, if rebates cannot be reliably estimated, revenue is not recognized until reliable estimates can be made or the rebate program lapses.

In addition to delivering internet advertising through its full-service DSP, the Company licenses a self-service version of its DSP technology platforms and its data management platform ("DMP") to agencies and advertisers for their own use. These arrangements do not provide the customer with the right to take possession of the software or platform. The Company also provides professional services to certain of its customers. Revenue from license agreements is recognized ratably over the license term. Professional services consist primarily of assisting these customers with on-site support, training and other consulting services. When professional services are not considered essential to the functionality of the software, revenue is recognized ratably over the service or related subscription term, whichever is longer, otherwise recognition is deferred until the services are completed.

Multiple-Element Arrangements—The Company enters into arrangements to sell advertising that includes different media placements or ad services that are delivered at the same time, or within close proximity of one another. The Company allocates arrangement consideration in multiple-deliverable revenue arrangements at the inception of an arrangement to all deliverables or those packages in which all components of the package are delivered at the same time, based on the relative selling price method in accordance with the selling price hierarchy, which includes: (1) vendor-specific objective evidence ("VSOE"), if available; (2) third-party evidence ("TPE"), if VSOE is not available; and (3) best estimate of selling price ("BESP"), if neither VSOE nor TPE is available.

VSOE—The Company determines VSOE based on its historical pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, the Company requires that a substantial majority of the stand-alone selling prices for these services fall within a reasonably narrow pricing range. The Company has not been able to establish VSOE for any of its advertising offerings.

TPE—When VSOE cannot be established for deliverables in multiple element arrangements, the Company applies judgment with respect to whether it can establish a selling price based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, the Company's go-to-market strategy differs from that of its peers and its offerings contain a significant level of differentiation such that the comparable pricing of services cannot be obtained. Furthermore, the Company is unable to reliably determine the selling prices of similar competitor services on a stand-alone basis. As a result, the Company has not been able to establish selling price based on TPE.

BESP—When it is unable to establish selling price using VSOE or TPE, the Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the service were sold on a stand-alone basis. BESP is generally used to allocate the selling price to deliverables in the Company's multiple element arrangements. The Company determines BESP for deliverables by considering multiple factors, including, but not limited to, prices it charges for similar offerings, market conditions, competitive landscape and pricing practices. In particular, the Company reviews multiple data points to determine BESP, including price lists used by the Company's sales team in pricing negotiations, historical average and median pricing achieved in prior contractual customer arrangements and input from the Company’s sales operation department regarding what it believes the deliverables could be sold for on a stand-alone basis. BESP is determined at an advertising unit level that is consistent with the Company’s underlying market strategy and stratified based on specific consideration of channel, geography, industry and size, as deemed necessary.

The Company limits the amount of allocable arrangement consideration to amounts that are fixed or determinable and that are not contingent on future performance or future deliverables. The Company regularly reviews BESP. Changes in assumptions or judgments or changes to the elements in the arrangement could cause a material increase or decrease in the amount of revenue that the Company reports in a particular period.

The Company recognizes the relative fair value of advertising services as they are delivered, assuming all other revenue recognition criteria are met. Deferred revenue is comprised of contractual billings in excess of recognized revenue and payments received in advance of revenue recognition.

Cost of Revenue—Cost of revenue consists primarily of media cost for advertising impressions purchased from real-time advertising exchanges and other third parties. Cost of revenue also includes third-party data center costs and the salaries and related costs of the Company’s operations group. This group sets up, initiates and monitors the Company’s advertising campaigns. In addition, depreciation of the data center equipment, rental payments to third-party vendors for data centers and amortization of capitalized internal-use software are included in cost of revenue.

Research and Development—Research and development expenses include costs associated with the maintenance and ongoing development of the Company’s technology, including compensation and employee benefits and allocated costs associated with the Company’s engineering and research and development departments, as well as costs for contracted services and supplies. Allocated costs include charges for facilities, office expenses, telephones, and other miscellaneous expenses. The Company reviews costs incurred in the application development stage and assesses such costs for potential capitalization.

Sales and Marketing—Sales and marketing expenses consist primarily of compensation (including commissions) and employee benefits of sales and marketing personnel and related support teams, allocated costs, certain advertising costs, travel, trade shows and marketing materials. Allocated costs include charges for facilities, office expenses, telephones, and other miscellaneous expenses. The Company incurred advertising costs of $1.5 million and $1.6 million for the three months ended September 30, 2014 and 2013, respectively, and $4.5 million and $3.3 million for the nine months ended September 30, 2014 and 2013, respectively.

General and Administrative—General and administrative expenses include facilities costs, executive and administrative compensation and employee benefits, depreciation, professional services fees, insurance costs, bad debt and other allocated costs, such as facility-related expenses, supplies and other fixed costs. Allocated costs include charges for facilities, office expenses, telephones, and other miscellaneous expenses.

Stock-based Compensation—The Company measures compensation expense for all stock-based payment awards, including stock options granted to employees, based on the estimated fair value of the awards on the date of the grant. The fair value of each stock option granted is estimated using the Black-Scholes option pricing model. Stock-based compensation is recognized on a straight-line basis over the requisite vesting period, net of estimated forfeitures. The forfeiture rate is based on an analysis of the Company’s actual historical forfeitures.

The Company accounts for stock options issued to non-employees based on the fair value of the awards determined using the Black-Scholes option pricing model.

Preferred Stock Warrant Liability—Freestanding warrants related to shares that are redeemable or contingently redeemable were classified as a liability on the Company’s condensed consolidated balance sheet. The fully-vested convertible preferred stock warrants were subject to re-measurement at each balance sheet date, and any change in fair value is recognized as a component of other expense, net. As completion of the Company’s initial public offering constituted a liquidation event, the convertible preferred stock warrants were converted into common stock or warrants to purchase common stock, and the liability was reclassified to additional paid-in capital in the third quarter of 2013.

Income Taxes—The Company accounts for income taxes using an asset and liability approach. Deferred income taxes reflect the net tax effects of