GoPro, Inc.
Form 10-Q
November 02, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________ to ________________
Commission file number: 001-36514
GOPRO, INC.
(Exact name of registrant as specified in its charter)

Delaware	77-0629474
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3000 Clearview Way San Mateo, California	94402
(Address of principal executive offices)	(Zip Code)

(650) 332-7600
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer þ Accelerated filer Non-accelerated filer

Smaller reporting company Emerging growth company
If an emerging growth company, indicated 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 þ
As of October 31, 2018, 114,103,292 and 35,897,231 shares of Class A and Class B common stock were outstanding, respectively.

GoPro, Inc.
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
GoPro, Inc.
Condensed Consolidated Balance Sheets
(unaudited)

(in thousands, except par values)	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 143,246	$ 202,504
Marketable securities	4,996	44,886
Accounts receivable, net	149,449	112,935
Inventory	123,249	150,551
Prepaid expenses and other current assets	31,958	62,811
Total current assets	452,898	573,687
Property and equipment, net	53,043	68,587
Intangible assets, net	15,147	24,499
Goodwill	146,459	146,459
Other long-term assets	21,026	37,014
Total assets	$ 688,573	$ 850,246
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 123,357	$ 138,257
Accrued liabilities	193,913	213,030
Deferred revenue	14,418	19,244
Total current liabilities	331,688	370,531
Long-term taxes payable	19,545	21,188
Long-term debt	136,659	130,048
Other long-term liabilities	28,635	29,774
Total liabilities	516,527	551,541
Commitments, contingencies and guarantees (Note 9)		
Stockholders' equity:		
Preferred stock, $0.0001 par value, 5,000 shares authorized; none issued	—	—
Common stock and additional paid-in capital, $0.0001 par value, 500,000 Class A shares authorized, 104,682 and 101,034 shares issued and outstanding, respectively; 150,000 Class B shares authorized, 35,901 and 35,966 shares issued and outstanding, respectively	886,360	854,452
Treasury stock, at cost, 10,710 and 10,710 shares, respectively	(113,613)	(113,613)
Accumulated deficit	(600,701)	(442,134)
Total stockholders' equity	172,046	298,705
Total liabilities and stockholders' equity	$ 688,573	$ 850,246

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

GoPro, Inc.
Condensed Consolidated Statements of Operations
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
(in thousands, except per share data)	2018	2017	2018	2017
Revenue	$285,936	$329,805	$770,959	$844,945
Cost of revenue	194,904	199,259	551,642	540,201
Gross profit	91,032	130,546	219,317	304,744
Operating expenses:				
Research and development	41,157	55,098	130,361	176,761
Sales and marketing	55,871	46,622	165,297	171,156
General and administrative	15,358	20,777	50,588	61,976
Total operating expenses	112,386	122,497	346,246	409,893
Operating income (loss)	(21,354)	8,049	(126,929)	(105,149)
Other income (expense):				
Interest expense	(4,616)	(4,554)	(13,804)	(9,152)
Other income (expense), net	661	322	(268)	705
Total other expense, net	(3,955)	(4,232)	(14,072)	(8,447)
Income (loss) before income taxes	(25,309)	3,817	(141,001)	(113,596)
Income tax (benefit) expense	1,780	(10,844)	(296)	13,429
Net income (loss)	$(27,089)	$14,661	$(140,705)	$(127,025)
Net income (loss) per share:				
Basic	$(0.19)	$0.11	$(1.01)	$(0.92)
Diluted	$(0.19)	$0.10	$(1.01)	$(0.92)
Shares used to compute net income (loss) per share:				
Basic	140,072	136,236	139,028	138,450
Diluted	140,072	140,288	139,028	138,450

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

GoPro, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Nine months ended September 30, 2018	2017
Operating activities:		
Net loss	$(140,705)	$(127,025)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	27,773	32,260
Stock-based compensation	31,171	36,235
Deferred income taxes	(987)	(1,818)
Non-cash restructuring charges	5,788	3,859
Non-cash interest expense	5,988	3,366
Other	(301)	3,891
Changes in operating assets and liabilities:		
Accounts receivable, net	(36,812)	64,874
Inventory	27,302	(9,998)
Prepaid expenses and other assets	32,203	4,850
Accounts payable and other liabilities	(36,467)	(106,432)
Deferred revenue	(3,350)	2,095
Net cash used in operating activities	(88,397)	(93,843)
Investing activities:		
Purchases of property and equipment, net	(8,204)	(18,313)
Purchases of marketable securities	(14,896)	(31,918)
Maturities of marketable securities	55,000	14,160
Sale of marketable securities	—	11,623
Net cash provided by (used in) investing activities	31,900	(24,448)
Financing activities:		
Proceeds from issuance of common stock	5,131	9,623
Taxes paid related to net share settlement of equity awards	(5,388)	(11,278)
Proceeds from issuance of convertible senior notes	—	175,000
Prepayment of forward stock repurchase transaction	—	(78,000)
Payment of deferred acquisition-related consideration	(2,450)	(76)
Payment of debt issuance costs	—	(5,963)
Net cash provided by (used in) financing activities	(2,707)	89,306
Effect of exchange rate changes on cash and cash equivalents	(54)	1,487
Net decrease in cash and cash equivalents	(59,258)	(27,498)
Cash and cash equivalents at beginning of period	202,504	192,114
Cash and cash equivalents at end of period	$143,246	$164,616

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

GoPro, Inc.
Notes to Condensed Consolidated Financial Statements

1. Summary of business and significant accounting policies
GoPro, Inc. and its subsidiaries (GoPro or the Company) is enabling the way people capture and share their lives from a perspective only achieved with a GoPro. What began as an idea to help athletes document themselves engaged in sport, GoPro has become a mobile storytelling solution that helps the world share itself through immersive content. To date, the Company's cameras and mountable and wearable accessories have generated substantially all of its revenue. The Company sells its products globally through retailers, wholesale distributors and on its website. The Company's global corporate headquarters are located in San Mateo, California.
Basis of presentation. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The Company's fiscal year ends on December 31, and its fiscal quarters end on March 31, June 30 and September 30. The condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, that management believes are necessary for the fair statement of the Company's financial statements, but are not necessarily indicative of the results expected for the full fiscal year or any other future period. The condensed consolidated balance sheet at December 31, 2017 has been derived from the audited financial statements at that date, but does not include all the disclosures required by GAAP. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K (Annual Report) for the year ended December 31, 2017. Except for accounting policies related to revenue recognition and income tax impacts of intra-entity asset transfers that were updated as a result of adopting Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, and ASU 2016-16, Income Taxes — Intra-Entity Transfers of Assets Other Than Inventory, respectively, there have been no significant changes in the Company's accounting policies from those disclosed in its Annual Report.
Principles of consolidation. These condensed consolidated financial statements include all the accounts of the Company and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.
Use of estimates. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported and disclosed in the Company's condensed consolidated financial statements and accompanying notes. Significant estimates and assumptions made by management include those related to revenue recognition (including sales incentives, sales returns and implied post contract support (PCS)), stock-based compensation, inventory valuation, product warranty liabilities, the valuation and useful lives of long-lived assets (property and equipment, intangible assets and goodwill) and income taxes. The Company bases its estimates and assumptions on historical experience and on various other factors that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from management's estimates. To the extent there are material differences between the estimates and the actual results, future results of operations could be affected.
Comprehensive income (loss). For all periods presented, comprehensive income (loss) approximated net income (loss). Therefore, the condensed consolidated statements of comprehensive income (loss) have been omitted.
Accounts receivable and allowance for doubtful accounts. Accounts receivable are stated at invoice value less estimated allowances for doubtful accounts. Allowances are recorded based on the Company's assessment of various factors, such as: historical experience, credit quality of its customers, age of the accounts receivable balances, geographic related risks, economic conditions and other factors that may affect a customer's ability to pay. The allowance for doubtful accounts as of September 30, 2018 and December 31, 2017 was $0.4 million and $0.8 million, respectively.
Warranty. The Company records a liability for estimated product warranty costs at the time product revenue is recognized. The Company's standard warranty obligation to its end-users generally provides a 12-month warranty coverage on all of its products except in the European Union where the Company provides a 2-year warranty. The Company also offers extended warranty programs for a fee. The Company's estimate of costs to service its warranty

obligations is based on its historical experience of repair and replacement of the associated products

GoPro, Inc.
Notes to Condensed Consolidated Financial Statements

and expectations of future conditions. The warranty obligation is affected by product failure rates and the related use of materials, labor costs and freight incurred in correcting any product failure.

Revenue recognition. The Company derives substantially all of its revenue from the sale of cameras, drones, mounts and accessories and the related implied post contract support to customers. The Company recognizes revenue when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. The transaction price the Company expects to be entitled to is primarily comprised of product revenue, net of returns and variable consideration, including sales incentives provided to customers. For most of the Company's revenue, revenue is recognized at the time products are delivered and when collection is deemed probable. For customers who purchase products directly from the Company's website, the Company retains a portion of the risk of loss on these sales during transit, which are accounted for as fulfillment costs. The Company provides sales commissions to internal and external sales representatives which are earned in the period in which revenue is recognized. As a result, the Company expenses such costs as incurred under ASU 2014-19.

The Company's standard terms and conditions of sale for non-web based sales do not allow for product returns other than under warranty. However, the Company grants limited rights of return to certain large retailers. The Company reduces revenue and cost of sales for the estimated returns based on analyses of historical return trends by customer class and other factors. An estimated refund liability along with a right to recover assets are recorded for future product returns. Return trends are influenced by product life cycles, new product introductions, market acceptance of products, product sell-through, the type of customer, seasonality and other factors. Return rates may fluctuate over time but are sufficiently predictable to allow the Company to estimate expected future product returns.

The Company's camera and drone sales contain multiple performance obligations that generally include the following three separate obligations: a) a hardware component (camera or drone) and the embedded firmware essential to the functionality of the hardware component delivered at the time of sale, b) the implicit right to the Company's downloadable free apps and software solutions, and c) the implied right for the customer to receive support after the initial sale (post contract support or PCS). The Company's PCS includes the right to receive on a when and if available basis, future unspecified firmware upgrades and features as well as bug fixes, and email and telephone support. The Company allocates the transaction price to PCS based on a cost-plus method. The transaction price is allocated to the remaining performance obligations on a residual value method. The Company's process to allocate the transaction price considers multiple factors that may vary over time depending upon the unique facts and circumstances related to each deliverable, including: the level of support provided to customers, estimated costs to provide the Company's support, the amount of time and cost that is allocated to the Company's efforts to develop the undelivered elements and market trends in the pricing for similar offerings.

The transaction prices allocated to the delivered hardware, related embedded firmware and free software solutions are recognized as revenue at the time of sale, provided the conditions for recognition of revenue have been met. The transaction price allocated to PCS is deferred and recognized as revenue on a straight-line basis over the estimated term of the support period, which is estimated to be 15 months based on historical experience. Deferred revenue as of September 30, 2018 and December 31, 2017 also included immaterial amounts related to the Company's GoPro Care and GoPro Plus fee-based service offerings. The Company's deferred revenue balance related to PCS was $13.5 million as of September 30, 2018 and the Company recognized $5.1 million and $15.8 million of related revenue during the three and nine months ended September 30, 2018, respectively.

Sales incentives. The Company offers sales incentives through various programs, including cooperative advertising, price protection, marketing development funds and other incentives. Sales incentives are considered to be variable consideration, which the Company estimates and records as a reduction to revenue at the date of sale. The Company estimates sales incentives based on historical experience, product sell-through and other factors.

Sales taxes. Sales taxes collected from customers and remitted to respective governmental authorities are recorded as liabilities and are not included in revenue.

Segment information. The Company operates as one operating segment as it only reports financial information on an aggregate and consolidated basis to its Chief Executive Officer, who is the Company’s chief operating decision maker.

GoPro, Inc.
Notes to Condensed Consolidated Financial Statements

Recent accounting standards

Standard	Description	Company's date of adoption	Effect on the condensed consolidated financial statements or other significant matters
Standards that were adopted			
Income Taxes ASU No. 2016-16 (Topic 740)	This standard requires entities to recognize the income tax consequences of intra-entity asset transfers when they occur, which removes the exception to postpone recognition until the asset has been sold to an outside party.	January 1, 2018	The adoption of the standard resulted in the recognition of previously unrecognized deferred charges using a modified retrospective method. The Company recorded a reversal of $15.0 million of deferred charges, an increase to U.S. deferred tax assets of $1.2 million with a corresponding U.S. valuation allowance of $1.2 million. The net impact to equity was an increase in the accumulated deficit of approximately $15.0 million upon adoption.
Stock Compensation ASU No. 2017-09 (Topic 718)	This standard clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under this standard, modification accounting is required only if the fair value, the vesting conditions or the classification of an award as equity or liability changes as a result of the change in terms or conditions.	January 1, 2018	The adoption of ASU 2017-09 did not impact the Company's condensed consolidated financial statements and related disclosures. The Company adopted the standard on a prospective basis.
Revenue from Contracts with Customers ASU No. 2014-09, 2015-14, 2016-08, 2016-10 and 2016-12 (Topic 606)	The updated revenue standard establishes principles for recognizing revenue and develops a common revenue standard for all industries. Under the new model, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard requires that entities disclose the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with	January 1, 2018	Under the updated revenue standard, the recognition of product revenue at the time the product is delivered, and PCS revenue on a straight-line basis remains consistent with the Company's previous revenue policy. Sales incentives are considered variable consideration under the new standard and are accounted for as a reduction to the transaction price. This change resulted in a reduction of revenue being recorded earlier than under the previous guidance. As a result of the adoption of the new standard, the Company recorded a $2.9 million increase to its accumulated deficit on January 1, 2018, of which, $4.9 million related to certain estimated sales incentives which would have been recognized at the time the product was shipped in the prior period. Additionally, for customers who purchased products directly from the Company's website, the new standard provides for a policy election whereby the Company has recorded revenue when the related product was shipped. This change resulted in recognition of revenue earlier than

customers.	under previous guidance. Upon adoption, the Company's accumulated deficit decreased by $2.0 million related to revenue that would have been recognized in the prior period from the Company's website sales that had shipped but had not been delivered as of December 31, 2017. In addition, the Company recorded a $1.0 million increase to deferred tax assets and a corresponding $1.0 million increase in valuation allowance. Additionally, under the new standard, the Company reclassed its refund liability from an offset to accounts receivable to an increase in accrued liabilities, which increased the Company's days sales outstanding. The Company adopted the standard using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Prior periods were not retrospectively adjusted. Refer below for the impact on each financial statement line item as of and for the three and nine months ended September 30, 2018 due to the adoption of the standard.

GoPro, Inc.
Notes to Condensed Consolidated Financial Statements

The cumulative effect of the changes made to the Company's condensed consolidated January 1, 2018 balance sheet for the adoption of ASU 2014-09, Revenue from Contracts with Customers and ASU 2016-16, Income Taxes — Intra-Entity Transfers of Assets Other Than Inventory, were as follows:

(in thousands)	Balance at December 31, 2017	Adjustment due to ASU 2014-09	Adjustment due to ASU 2016-16	Balance at January 1, 2018
Accumulated deficit	$(442,134)	$(2,872)	$(14,990)	$(459,996)

As mentioned above, the adoption of ASU 2014-09 impacted the timing of revenue recognized related to certain sales incentives and sales from the Company's website, which impacted the revenue and current deferred revenue financial statement line items. Additionally, under ASU 2014-09, the Company presents an estimated refund liability along with a right to recover asset for future product returns, which impacts the accounts receivable, net, inventory, net, prepaid expenses and other assets, and accrued liabilities financial statement line items resulting in an increase in the Company's accounts receivable days sales outstanding (DSO) calculation. The above adjustments do not impact net cash used in operating activities, however, they do impact the changes in operating assets and liabilities for the related accounts within the disclosure of operating activities on the statement of cash flow. Refer to the tables below for the quantitative impact to the Company's financial statements for the periods ended September 30, 2018 due to the adoption of ASU 2014-09 (ASC 606).

	Three months ended September 30, 2018			Nine months ended September 30, 2018		
(in thousands)	As Reported Under ASC 606	Effect of Change	Balance Under ASC 605	As Reported Under ASC 606	Effect of Change	Balance Under ASC 605
Revenue	$285,936	$(3,076)	$282,860	$770,959	$ 189	$771,148

	As of September 30, 2018		
(in thousands)	As Reported Under ASC 606	Effect of Change	Balance Under ASC 605
Accounts receivable, net	$149,449	$(13,728)	$135,721
Inventory, net	123,249	6,012	129,261
Prepaid expenses and other current assets	31,958	(6,012)	25,946
Accrued liabilities	193,913	(13,728)	180,185
Current deferred revenue	14,418	4,931	19,349

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Standard	Description	Expected date of adoption	Effect on the condensed consolidated financial statements or other significant matters
Standards not yet adopted			
Leases ASU No. 2016-02, 2018-10, 2018-11, (Topic 842)	This standard requires lessees to put most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. Lessees would recognize a right-to-use asset and lease liability for all leases with terms of more than 12 months. The new standard should be applied on a modified retrospective basis or cumulative effect transition method.	January 1, 2019	The Company has completed the process of identifying its population of lease arrangements impacted by this standard, and plans to adopt the standard using the cumulative effect transition method. Upon adoption, the Company expects that the majority of its operating lease commitments will materially increase total assets and total liabilities on the Company's condensed consolidated balance sheets. While the Company continues to assess potential impacts of the standard, the Company does not expect the standard to have a material impact on the condensed consolidated income statements and condensed consolidated statement of cash flows.
Intangible - Goodwill and Other ASU No. 2017-04 (Topic 350)	This standard simplifies the accounting for goodwill and removes Step 2 of the annual goodwill impairment test. Upon adoption, goodwill impairment will be determined based on the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017, and requires a prospective transition method.	January 1, 2020	The Company does not expect that the adoption of this standard will have a material impact on its condensed consolidated financial statements and related disclosures.

Although there are several other new accounting standards issued or proposed by the FASB, which the Company has adopted or will adopt, as applicable, the Company does not believe any of these additional accounting pronouncements has had or will have a material impact on its financial statements.

2. Fair value measurements

The Company's assets that are measured at fair value on a recurring basis within the fair value hierarchy are summarized as follows:

	September 30, 2018			December 31, 2017		
(in thousands)	Level 1	Level 2	Total	Level 1	Level 2	Total
Cash equivalents [1]:						
Money market funds	$58,572	$—	$58,572	$25,251	$—	$25,251
Commercial paper	—	—	—	14,981	—	14,981
Corporate debt securities	—	—	—	—	2,500	2,500
Agency securities	—	—	—	—	4,999	4,999
Total cash equivalents	$58,572	$—	$58,572	$40,232	$7,499	$47,731

Marketable securities:						
U.S. treasury securities	$—	$—	$—	$—	$4,995	$4,995
Commercial paper	—	—	—	19,888	—	19,888
Corporate debt securities	—	4,996	4,996	—	20,003	20,003
Total marketable securities	$—	$4,996	$4,996	$19,888	$24,998	$44,886

(1) Included in cash and cash equivalents in the accompanying condensed consolidated balance sheets. Cash balances were $84.7 million and $154.8 million as of September 30, 2018 and December 31, 2017, respectively.

GoPro, Inc.
Notes to Condensed Consolidated Financial Statements

There were no transfers of financial assets between levels for the periods presented.
Cash equivalents and marketable securities are classified as Level 1 or Level 2 because the Company uses quoted market prices or alternative pricing sources and models utilizing market observable inputs to determine their fair value. The contractual maturities of available-for-sale marketable securities as of September 30, 2018 and December 31, 2017 were all less than one year in duration. At September 30, 2018 and December 31, 2017, the Company had no financial assets or liabilities that were classified as Level 3, which are valued based on inputs supported by little or no market activity.
At September 30, 2018 and December 31, 2017, the amortized cost of the Company's cash equivalents and marketable securities approximated their fair value and there were no material realized or unrealized gains or losses, either individually or in the aggregate.
In April 2017, the Company issued $175.0 million principal amount of Convertible Senior Notes due 2022 (Notes) (see Note 4, Financing Arrangements). The estimated fair value of the Notes is based on quoted market prices of the Company's instruments in markets that are not active and are classified as Level 2 within the fair value hierarchy. The Company estimated the fair value of the Notes by evaluating quoted market prices and calculating the upfront cash payment a market participant would require to assume these obligations. The calculated fair value of the Notes, of $166.3 million, is highly correlated to the Company's stock price and as a result, significant changes to the Company's stock price will have a significant impact on the calculated fair value of the Notes.
For certain other financial assets and liabilities, including accounts receivable, accounts payable and other current assets and liabilities, the carrying amounts approximate their fair value primarily due to the relatively short maturity of these balances.

3. Condensed consolidated financial statement details
The following sections and tables provide details of selected balance sheet items.
Inventory

(in thousands)	September 30, 2018	December 31, 2017
Components	$ 21,150	$ 18,995
Finished goods	102,099	131,556
Total inventory	$ 123,249	$ 150,551

Property and equipment, net

(in thousands)	September 30, 2018	December 31, 2017
Leasehold improvements	$ 66,466	$ 67,713
Production, engineering and other equipment	50,704	47,502
Tooling	17,661	24,871
Computers and software	20,828	20,636
Furniture and office equipment	15,114	14,895
Tradeshow equipment and other	6,965	7,237
Construction in progress	121	347
Gross property and equipment	177,859	183,201
Less: Accumulated depreciation and amortization	(124,816)	(114,614)
Property and equipment, net	$ 53,043	$ 68,587

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Notes to Condensed Consolidated Financial Statements

Intangible assets

	September 30, 2018		
(in thousands)	Gross carrying value	Accumulated amortization	Net carrying value
Purchased technology	$50,501	$ (35,369)	$15,132
Domain name	15	—	15
Total intangible assets	$50,516	$ (35,369)	$15,147

	December 31, 2017		
(in thousands)	Gross carrying value	Accumulated amortization	Net carrying value
Purchased technology	$49,901	$ (26,017)	$23,884
IPR&D	615	—	615
Total intangible assets	$50,516	$ (26,017)	$24,499

For the three and nine months ended September 30, 2018 and 2017, the Company did not record any impairment charges for in-process research and development (IPR&D) assets.

Amortization expense was $3.4 million and $2.2 million for the three months ended September 30, 2018 and 2017, respectively, and $9.4 million and $6.7 million for the nine months ended September 30, 2018 and 2017, respectively. At September 30, 2018, expected amortization expense of intangible assets with definite lives for future periods is as follows:

(in thousands)	Total
Year ending December 31,	
2018 (remaining 3 months)	$2,082
2019	7,818
2020	4,363
2021	869
2022	—
	$15,132

Other long-term assets

(in thousands)	September 30, 2018	December 31, 2017
Point of purchase (POP) displays	$ 11,106	$ 16,451
Long-term deferred tax assets	1,543	825
Deposits and other	8,377	19,738
Other long-term assets	$ 21,026	$ 37,014

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Accrued liabilities

(in thousands)	September 30, 2018	December 31, 2017
Accrued payables [(1)]	$ 44,500	$ 44,582
Employee related liabilities [(1)]	18,445	24,945
Accrued sales incentives	37,070	89,549
Refund liability	13,728	—
Warranty liability	9,258	9,934
Customer deposits	4,166	8,700
Income taxes payable	2,229	1,247
Purchase order commitments	4,767	6,162
Inventory received	54,556	14,470
Other	5,194	13,441
Accrued liabilities	$ 193,913	$ 213,030

[(1)] See Note 11 Restructuring charges, for amounts associated with restructuring liabilities.

Product warranty

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2018	2017	2018	2017
Beginning balance	$10,692	$9,974	$10,373	$11,945
Charged to cost of revenue	5,055	5,986	18,163	13,394
Settlement of warranty claims	(5,878)	(6,273)	(18,667)	(15,652)
Ending balance	$9,869	$9,687	$9,869	$9,687

4. Financing Arrangements

Credit Facility

In March 2016, the Company entered into a Credit Agreement (Credit Agreement) with certain banks which provides for a secured revolving credit facility (Credit Facility) under which the Company may borrow up to an aggregate amount of $250.0 million. The Company and its lenders may increase the total commitments under the Credit Facility to up to an aggregate amount of $300.0 million, subject to certain conditions. The Credit Facility will terminate and any outstanding borrowings become due and payable in March 2021.

The amount that may be borrowed under the Credit Facility is determined at periodic intervals and is based upon the Company’s inventory and accounts receivable balances. Borrowed funds accrue interest, at the Company’s election, based on an annual rate of (a) London Interbank Offered Rate (LIBOR) or (b) the administrative agent’s base rate, plus an applicable margin of between 1.50% and 2.00% for LIBOR rate loans, and between 0.50% and 1.00% for base rate loans. The Company is required to pay a commitment fee on the unused portion of the Credit Facility of 0.25% or 0.375% per annum, based on the level of utilization of the Credit Facility. Amounts owed under the Credit Agreement and related credit documents are guaranteed by GoPro, Inc. and its material subsidiary. GoPro, Inc. and its Netherlands subsidiary have also granted security interests in substantially all of their assets to collateralize this obligation.

The Credit Agreement contains customary covenants, such as financial statement reporting requirements and limiting the ability of the Company and its subsidiaries to pay dividends or incur debt, create liens and encumbrances, make investments, and redeem or repurchase stock. The Company is required to maintain a minimum fixed charge coverage ratio if and when the unborrowed availability under the Credit Facility is less than the greater of $25.0 million or 10.0% of the borrowing base at such time. The Credit Agreement also contains customary events of default, such as the failure to pay obligations when due, initiation of bankruptcy or insolvency

proceedings, or defaults on certain other indebtedness. Upon an event of default, the lenders may, subject to customary cure rights, require the immediate payment of all amounts outstanding and foreclose on collateral.

At September 30, 2018 and December 31, 2017, the Company could borrow up to approximately $101.6 million and $118.0 million, respectively, under the Credit Facility, and was in compliance with all financial covenants contained in the Credit Agreement. The Company has made no borrowings from the Credit Facility to date.

Convertible Notes

In April 2017, the Company issued $175.0 million aggregate principal amount of 3.50% Convertible Senior Notes due 2022 (Notes). The Notes are senior, unsecured obligations of GoPro and mature on April 15, 2022 (Maturity Date), unless earlier repurchased or converted into shares of Class A common stock under certain circumstances. The Notes are convertible into cash, shares of the Company's Class A common stock, or a combination thereof, at the Company's election, at an initial conversion rate of 94.0071 shares of Class A common stock per $1,000 principal amount of the Notes, which is equivalent to an initial conversion price of approximately $10.64 per share of common stock, subject to adjustment. Based on current and projected liquidity, the Company has the intent and ability to deliver cash up to the principal amount of the Notes then outstanding upon conversion. The Company pays interest on the Notes semi-annually in arrears on April 15 and October 15 of each year.

The $175.0 million of proceeds received from the issuance of the Notes were allocated between long-term debt (liability component) of $128.3 million and additional paid-in-capital (equity component) of $46.7 million on the condensed consolidated balance sheet. The fair value of the liability component was measured using rates determined for similar debt instruments without a conversion 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 aggregate face value of the Notes. The liability component will be accreted up to the face value of the Notes of $175.0 million, which will result in additional non-cash interest expense being recognized in the condensed consolidated statements of operations through the Notes' Maturity Date. The accretion of the Notes to par and debt issuance cost is amortized into interest expense over the term of the Note using an effective interest rate of approximately 10.5%. The equity component will not be remeasured as long as it continues to meet the conditions for equity classification.

The Company incurred approximately $5.7 million of issuance costs related to the issuance of the Notes, of which $4.2 million and $1.5 million were recorded to long-term debt and additional paid-in capital, respectively. The $4.2 million of issuance costs recorded as long-term debt on the condensed consolidated balance sheet are being amortized over the five-year contractual term of the Notes using the effective interest method.

The Company may not redeem the Notes prior to the Maturity Date and no sinking fund is provided for the Notes. The indenture includes customary terms and covenants, including certain events of default after which the Notes may be due and payable immediately.

Holders have the option to convert the Notes in multiples of $1,000 principal amount at any time prior to January 15, 2022, but only in the following circumstances:

- during any calendar quarter beginning after the calendar quarter ending on September 30, 2017, if the last reported sale price of Class A common stock for at least 20 trading days (whether or not consecutive) during the last 30 consecutive trading days of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price of the Notes on each applicable trading day;
- during the five-business day period following any five consecutive trading day period in which the trading price for the Notes is less than 98% of the product of the last reported sale price of Class A common stock and the conversion rate for the Notes on each such trading day; or
- upon the occurrence of specified corporate events.

At any time on or after January 15, 2022 until the second scheduled trading day immediately preceding the Maturity Date of the Notes on April 15, 2022, a holder may convert its Notes, in multiples of $1,000 principal amount. Holders of the Notes who convert their Notes in connection with a make-whole fundamental change (as defined in the indenture) are, under certain circumstances, entitled to an increase in the conversion rate. In addition, in the event of a fundamental change prior to the Maturity Date, holders will, subject to certain

conditions, have the right, at their option, to require the Company to repurchase for cash all or part of the Notes at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest up to, but excluding, the repurchase date.

As of September 30, 2018, the outstanding principal on the Notes was $175.0 million, the unamortized debt discount was $35.4 million, the unamortized debt issuance cost was $2.9 million and the net carrying amount of the liability component was $136.7 million, which was recorded as long-term debt within the condensed consolidated balance sheet. For the three months ended September 30, 2018 and 2017, the Company recorded interest expense of $1.5 million for contractual coupon interest, $0.2 million for amortization of debt issuance costs, and $2.0 million and $1.8 million, respectively, for amortization of the debt discount. For the nine months ended September 30, 2018 and 2017, the Company recorded interest expense of $4.6 million and $2.8 million, respectively, for contractual coupon interest, $0.6 million and $0.4 million, respectively, for amortization of debt issuance costs, and $6.0 million and $3.4 million, respectively, for amortization of the debt discount.

In connection with the offering, the Company entered into a prepaid forward stock repurchase transaction (Prepaid Forward) with a financial institution (Forward Counterparty). Pursuant to the Prepaid Forward, the Company used approximately $78.0 million of the net proceeds from the offering of the Notes to fund the Prepaid Forward. The aggregate number of shares of the Company’s Class A common stock underlying the Prepaid Forward was approximately 9.2 million. The expiration date for the Prepaid Forward is April 15, 2022, although it may be settled earlier in whole or in part. Upon settlement of the Prepaid Forward, at expiration or upon any early settlement, the Forward Counterparty will deliver to the Company the number of shares of Class A common stock underlying the Prepaid Forward or the portion thereof being settled early. The shares purchased under the Prepaid Forward are treated as treasury stock on the condensed consolidated balance sheet (and not outstanding for purposes of the calculation of basic and diluted earnings per share), but will remain outstanding for corporate law purposes, including for purposes of any future stockholders’ votes, until the Forward Counterparty delivers the shares underlying the Prepaid Forward to the Company. The Company’s Prepaid Forward hedge transaction exposes the Company to credit risk to the extent that its counterparty may be unable to meet the terms of the transaction. The Company mitigates this risk by limiting its counterparty to a major financial institution.

5. Employee benefit plans

Equity incentive plans. The Company has outstanding equity grants from its three stock-based employee compensation plans: the 2014 Equity Incentive Plan (2014 Plan), the 2010 Equity Incentive Plan (2010 Plan) and the 2014 Employee Stock Purchase Plan (ESPP). No new options or awards have been granted under the 2010 Plan since June 2014. Outstanding options and awards under the 2010 Plan continue to be subject to the terms and conditions of the 2010 Plan. Options granted under the 2014 Plan generally expire within ten years from the date of grant and generally vest over one to four years. Restricted stock units (RSUs) granted under the 2014 Plan generally vest over two to four years based upon continued service and are settled at vesting in shares of the Company’s Class A common stock. Performance stock units (PSUs) granted under the 2014 Plan generally vest over three years based upon continued service and the Company achieving certain revenue targets, and are settled at vesting in shares of the Company’s Class A common stock. The ESPP allows eligible employees to purchase shares of the Company’s Class A common stock through payroll deductions at a price equal to 85% of the lesser of the fair market value of the stock as of the first date or the ending date of each six month offering period. For additional information regarding the Company’s equity incentive plans, refer to the audited financial statements contained in the 2017 Annual Report.

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Stock options

A summary of the Company's stock option activity for the nine months ended September 30, 2018 is as follows:

	Shares (in thousands)	Weighted-average exercise price	Weighted-average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2017	9,809	$ 11.16	6.00	$ 19,971
Granted	1,333	5.77		
Exercised	(605)	0.74		
Forfeited/Cancelled	(4,326)	16.48		
Outstanding at September 30, 2018	6,211	$ 7.32	5.85	$ 16,883
Vested and expected to vest at September 30, 2018	6,204	$ 7.31	5.85	$ 16,883
Exercisable at September 30, 2018	4,432	$ 7.35	4.50	$ 14,972

The aggregate intrinsic value of the stock options outstanding as of September 30, 2018 represents the value of the Company's closing stock price on September 30, 2018 in excess of the exercise price multiplied by the number of options outstanding.

Restricted stock units

A summary of the Company's RSU activity for the nine months ended September 30, 2018 is as follows:

	Shares (in thousands)	Weighted-average grant date fair value
Non-vested shares at December 31, 2017	9,483	$ 11.87
Granted	4,033	5.87
Vested	(2,919)	11.57
Forfeited	(2,864)	11.93
Non-vested shares at September 30, 2018	7,733	$ 8.83

In June 2014, the Company granted an award of 4.5 million RSUs covering shares of the Company's Class B common stock to the Company's CEO (CEO RSUs), which included 1.5 million RSUs that vested immediately upon grant and 3.0 million RSUs that were subject to both a market-based vesting condition and a three year service-based vesting condition. The market-based condition was achieved in January 2015. Stock-based compensation expense related to the CEO RSUs was zero for the three months ended September 30, 2018 and 2017, and zero and $0.6 million, for the nine months ended September 30, 2018 and 2017, respectively.

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Performance stock units
In 2018, the Company granted PSUs to certain executives and employees. PSUs are subject to both a one year performance-based vesting condition and a three year service-based vesting condition. The performance-based condition is related to the Company achieving certain revenue targets.
A summary of the Company’s PSU activity for the nine months ended September 30, 2018 is as follows:

	Shares (in thousands)	Weighted-average grant date fair value
Non-vested shares at December 31, 2017	—	$ —
Granted	334	5.76
Vested	—	—
Forfeited	—	—
Non-vested shares at September 30, 2018	334	$ 5.76

Employee stock purchase plan. For the nine months ended September 30, 2018 and 2017, the Company issued 980,727 and 934,359 shares under its ESPP, respectively, at weighted average prices of $4.78 and $8.02, respectively.
Stock-based compensation expense. The Company measures compensation expense for all stock-based payment awards based on the estimated fair values on the date of the grant. The fair value of stock options granted and ESPP issuance is estimated using the Black-Scholes option pricing model. The fair value of RSUs and PSUs are determined using the Company’s closing stock price on the date of grant. The Company accounts for forfeitures of stock-based payment awards in the period they occur. There have been no significant changes in the Company’s valuation assumptions from those disclosed in its 2017 Annual Report.
The following table summarizes stock-based compensation expense included in the condensed consolidated statements of operations:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2018	2017	2018	2017
Cost of revenue	$534	$445	$1,406	$1,355
Research and development	4,977	5,967	14,942	17,039
Sales and marketing	2,429	2,609	7,489	7,295
General and administrative	2,397	2,854	7,334	10,546
Total stock-based compensation expense	$10,337	$11,875	$31,171	$36,235

The income tax benefit related to stock-based compensation expense was zero for the three and nine months ended September 30, 2018 and 2017 due to a full valuation allowance on the Company’s U.S. net deferred tax assets (see Note 7 Income taxes, below).
At September 30, 2018, total unearned stock-based compensation of $60.8 million related to stock options, RSUs, PSUs and ESPP shares is expected to be recognized over a weighted average period of 2.2 years.

GoPro, Inc.
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6. Net income (loss) per share
The following table presents the calculations of basic and diluted net income (loss) per share:

(in thousands, except per share data)	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Numerator:				
Net income (loss)	$(27,089)	$14,661	$(140,705)	$(127,025)
Denominator:				
Weighted-average common shares—basic for Class A and Class B common stock	140,072	136,236	139,028	138,450
Effect of dilutive stock-based awards	—	4,052	—	—
Weighted-average common shares diluted for Class A and Class B common stock	140,072	140,288	139,028	138,450
Net income (loss) per share				
Basic	$(0.19)	$0.11	$(1.01)	$(0.92)
Diluted	$(0.19)	$0.10	$(1.01)	$(0.92)

The following potentially dilutive shares were not included in the calculation of diluted shares outstanding as the effect would have been anti-dilutive:

(in thousands)	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Effect of anti-dilutive stock-based awards	15,072	10,573	15,933	10,837

The Company's Notes mature on April 15, 2022, unless earlier repurchased or converted into shares of Class A common stock under certain circumstances as described further in Note 4, Financing Arrangements, above. The Notes are convertible into cash, shares of the Company's Class A common stock, or a combination thereof, at the Company's election. Based on the Company's current and projected liquidity, the Company has the intent and ability to deliver cash up to the principal amount of the Notes subject to conversion. As such, no shares associated with the Note conversion were included in the Company's weighted-average number of common shares outstanding for any periods presented. While the Company has the intent and ability to deliver cash up to the principal amount, the maximum number of shares issuable upon conversion of the Notes is 20.6 million shares of Class A common stock.
Additionally, the calculation of weighted-average shares outstanding for the three months ended September 30, 2018 and 2017 excludes approximately 9.2 million shares, and for the nine months ended September 30, 2018 and 2017, excludes approximately 9.2 million shares and 5.8 million shares, respectively, effectively repurchased and held in treasury stock on the condensed consolidated balance sheet as a result of the Prepaid Forward transaction entered into in connection with the Note offering.
The rights of the holders of Class A common stock and Class B common stock are identical, except with respect to voting and conversion. Each share of Class A common stock is entitled to one vote per share and each share of Class B common stock is entitled to ten votes per share. Each share of Class B common stock is convertible at any time at the option of the stockholder into one share of Class A common stock and has no expiration date. Each share of Class B common stock will convert automatically into one share of Class A common stock upon the date when the outstanding shares of Class B common stock represent less than 10% of the aggregate number of shares of common stock then outstanding. Class A common stock is not convertible into Class B common stock. The computation of the diluted net loss per share of Class A common stock assumes the conversion of Class B common stock.

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7. Income taxes

The Company's income tax expense and the resulting effective tax rate are based upon the estimated annual effective tax rates applicable for the respective period, including losses generated in countries where the Company is projecting annual losses for which deferred tax assets are not anticipated to be recognized. In the fourth quarter of 2016, the Company recorded a full valuation allowance against its net U.S. deferred tax assets, and for the foreseeable future anticipates providing a valuation allowance against any additional deferred tax assets until such time it is more likely than not the benefit of these deferred tax assets may be recognized.

The Company's tax provision and the resulting effective tax rate for interim periods is determined based upon its estimated annual effective tax rate, adjusted for the effect of discrete items arising in that quarter. The Company also includes jurisdictions with a projected loss for the year (or year-to-date loss) where the Company cannot or does not expect to recognize a tax benefit from its estimated annual effective tax rate. The impact of such inclusions could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings or losses versus annual projections. In each quarter, the Company updates its estimate of the annual effective tax rate, and if the estimated annual tax rate changes, a cumulative adjustment is made in that quarter.

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands)	2018	2017	2018	2017
Income tax (benefit) expense	$1,780	$(10,844)	$(296)	$13,429
Effective tax rate	(7.0)%	(284.1)%	0.2%	(11.8)%

The Company recorded an income tax expense of $1.8 million for the three months ended September 30, 2018 on a pre-tax net loss of $25.3 million, which resulted in a negative effective tax rate of 7.0%. The Company's income tax expense for the three months ended September 30, 2018 was primarily composed of $1.5 million of tax expense incurred on pre-tax income in profitable foreign jurisdictions, one-time items that included $7.0 million of net non-deductible equity tax expense, and $0.4 million of tax expense related to foreign provision to return adjustments, partially offset by a $1.1 million tax benefit relating to restructuring expense and a $6.3 million net decrease in the valuation allowance. The Company recorded an income tax benefit of $0.3 million for the nine months ended September 30, 2018 on a pre-tax net loss of $141.0 million, which resulted in an effective tax rate of 0.2%. The Company's income tax benefit for the nine months ended September 30, 2018 was composed of $2.4 million of tax expenses incurred on pre-tax income in profitable foreign jurisdictions, one-time items that included $10.9 million of tax benefit primarily relating to the conclusion of the IRS audit and the release of uncertain tax positions, $9.6 million of net non-deductible equity tax expense, $5.4 million of tax benefit relating to restructuring expenses, $0.6 million of uncertain tax position interest expense and $0.3 million tax expense related to foreign provision to return adjustments, offset by a $3.1 million net increase in the valuation allowance.

For the three months ended September 30, 2017, the Company recorded an income tax benefit of $10.8 million on a pre-tax net income of $3.8 million, which resulted in a negative effective tax rate of 284.1%. The Company's income tax benefit for the three months ended September 30, 2017 related primarily to foreign taxes and a cumulative adjustment due to the change in the Company's estimated annual tax rate. The Company recorded an income tax provision of $13.4 million for the nine months ended September 30, 2017 on a pre-tax net loss of $113.6 million, which resulted in a negative effective tax rate of 11.8%. The Company's income tax provision for the nine months ended September 30, 2017 was principally composed of tax expense incurred on pre-tax income in profitable foreign jurisdictions based on the Company's estimated annual tax rate.

Due to certain tax structure changes effective January 1, 2018, including the planned liquidation of the Company's subsidiary, Woodman Labs Cayman, Inc., the Company's tax provision and resulting effective tax rate for interim periods in 2018 and future years is expected to be subject to less volatility and fluctuation quarter over quarter than in 2017. Further, for both 2018 and 2017, while the Company incurred pre-tax losses in the United States and certain lower-rate jurisdictions, the Company does not expect to recognize any tax benefits on pre-tax losses in the United States due to a full valuation allowance recorded against its U.S. deferred tax assets.

During the nine months ended September 30, 2018, the Internal Revenue Service concluded its audit for the 2012 through 2015 tax years. The Closing Agreement was received on January 24, 2018 and the Company received an income tax refund of approximately $32.9 million, net of IRS adjustments, in February 2018. As a result, the Company recognized a reduction in gross unrecognized tax benefits of $26.0 million and an income tax benefit, net of valuation allowance, of approximately $2.6 million.

At September 30, 2018 and December 31, 2017, the Company's gross unrecognized tax benefits were $33.5 million and $58.6 million, respectively. If recognized, $16.9 million of these unrecognized tax benefits (net of U.S. federal benefit) at September 30, 2018 would be recorded as a reduction of future income tax provision. These unrecognized tax benefits relate primarily to unresolved matters with taxing authorities regarding tax positions based on the Company's interpretation of certain U.S. trial and appellate court decisions, which remain subject to appeal and therefore could be overturned in future periods and tax positions on IP transfers. Although the completion, settlement and closure of any audits is uncertain, it is reasonably possible that the total amount of unrecognized tax benefits will not materially change within the next 12 months. However, given the number of years remaining that are subject to examination, the range of the reasonably possible change cannot be estimated reliably.

U.S. Tax Reform. The Tax Cuts and Jobs Act (TCJA) of 2017, enacted on December 22, 2017, reduced the U.S. statutory tax rate from 35% to 21%, effective January 1, 2018. The TCJA also implemented a territorial tax system. Under the territorial tax system, in general, the Company's foreign earnings would no longer be subject to tax in the U.S. As part of transitioning to the territorial tax system, the TCJA includes a mandatory deemed repatriation of all undistributed foreign earnings that are subject to a U.S. income tax. The Company estimates that the deemed repatriation will not result in any additional U.S. income tax. This estimate may be impacted by a number of additional considerations, including, but not limited to, the issuance of final regulations and the Company's ongoing analysis of the new law.

While the TCJA provides for a territorial tax system, beginning in 2018, it includes two new U.S. tax base erosion provisions, the global intangible low-taxed income (GILTI) provisions and the base-erosion and anti-abuse tax (BEAT) provisions. The GILTI provisions require the Company to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary's tangible assets. The BEAT provisions in the TCJA eliminate the deduction of certain base-erosion payments made to related foreign corporations and impose a minimum tax if greater than regular tax. The BEAT or GILTI provisions did not result in significant additional U.S. tax beginning in 2018.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (SAB 118) to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the TCJA. The Company has recognized the provisional tax impacts related to deemed repatriated earnings and the revaluation of deferred tax assets and liabilities to the extent needed and included these amounts in its consolidated financial statements for the year ended December 31, 2017. The ultimate impact may differ from these provisional amounts, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the TCJA. The accounting is expected to be complete when the 2017 U.S. corporate income tax return is filed in 2018.

8. Related party transactions

The Company incurs costs for Company-related chartered aircraft fees for the use of the CEO's private plane. The Company recorded a de minimis expense in the three and nine months ended September 30, 2018 and September 30, 2017. As of September 30, 2018 and December 31, 2017, the Company had $0.1 million and zero accounts payable associated with these aircraft fees, respectively.

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9. Commitments, contingencies and guarantees

Facility Leases. The Company leases its facilities under long-term operating leases, which expire at various dates through 2027. As of September 30, 2018, the Company's total future minimum lease payments under non-cancelable operating leases were $109.7 million. There have been no material changes to the Company's lease commitments since December 31, 2017. Rent expense was $3.6 million and $4.6 million for the three months ended September 30, 2018 and 2017, respectively, and $10.3 million and $14.6 million for the nine months ended September 30, 2018 and 2017, respectively.

Other Commitments. In the ordinary course of business, the Company enters into multi-year agreements to purchase sponsorships with event organizers, resorts and athletes as part of its marketing efforts; software licenses related to its financial and IT systems; debt agreements; and various other contractual commitments. As of September 30, 2018, the Company's total undiscounted future expected obligations under multi-year agreements described above with terms longer than one year was $181.0 million. There have been no material changes to the Company's other commitments since December 31, 2017.

Legal proceedings. From time to time, the Company is involved in legal proceedings in the ordinary course of business, including the litigation matters described in Part II, Item 1 of this Quarterly Report on Form 10-Q. Due to inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of these matters. The Company is unable at this time to determine whether the outcome of the litigation would have a material impact on the results of operations, financial condition or cash flows of the Company.

Indemnifications. In the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and provide for general indemnification. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. It is not possible to determine the maximum potential amount under these indemnification agreements due to the Company's limited history with indemnification claims and the unique facts and circumstances involved in each particular agreement. As of September 30, 2018, the Company has not paid any claims nor has it 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.

10. Concentrations of risk and geographic information

Customer concentration. Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of trade receivables. The Company believes that credit risk for accounts receivable is mitigated by the Company's credit evaluation process, relatively short collection terms and dispersion of its customer base. The Company generally does not require collateral and losses on trade receivables have historically been within management's expectations.

Customers who represented 10% or more of the Company's net accounts receivable balance were as follows:

	September 30, 2018	December 31, 2017
Customer A	12%	32%
Customer B	*	16%
Customer C	*	12%
Customer D	*	11%

* Less than 10% of net accounts receivable for the period indicated.

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The following table summarizes the Company's accounts receivables sold, without recourse, and factoring fees paid:

(in thousands)	Three months ended September 30, 2018	2017	Nine months ended September 30, 2018	2017
Accounts receivable sold	$31,164	$51,593	$83,618	$130,555
Factoring fees	401	473	1,056	1,153

Customers who represented 10% or more of the Company's total revenue were as follows:

	Three months ended September 30, 2018	2017	Nine months ended September 30, 2018	2017
Customer A	13%	16%	14%	16%

Supplier concentration. The Company relies on third parties for the supply and manufacture of its products, some of which are sole-source suppliers. The Company believes that outsourcing manufacturing enables greater scale and flexibility. As demand and product lines change, the Company periodically evaluates the need and advisability of adding manufacturers to support its operations. In instances where a supply and manufacture agreement does not exist or suppliers fail to perform their obligations, the Company may be unable to find alternative suppliers or satisfactorily deliver its products to its customers on time, if at all. The Company also relies on third parties with whom it outsources supply chain activities related to inventory warehousing, order fulfillment, distribution and other direct sales logistics.

Geographic information

Revenue by geographic region, based on ship-to destinations, was as follows:

(in thousands)	Three months ended September 30, 2018	2017	Nine months ended September 30, 2018	2017
Americas	$119,524	$163,430	$341,576	$416,164
Europe, Middle East and Africa (EMEA)	96,056	97,179	249,207	245,256
Asia and Pacific (APAC)	70,356	69,196	180,176	183,525
Total revenue	$285,936	$329,805	$770,959	$844,945

Revenue in the United States, which is included in the Americas geographic region, was $94.0 million and $148.4 million for the three months ended September 30, 2018 and 2017, respectively, and $286.5 million and $375.9 million for the nine months ended September 30, 2018 and 2017, respectively. No other individual country exceeded 10% of total revenue for any period presented. The Company does not disclose revenue by product category as it does not track sales incentives and other revenue adjustments by product category to report such data.

As of September 30, 2018 and December 31, 2017, long-lived assets, which represent gross property and equipment, located outside the United States, primarily in Hong Kong and China, were $74.2 million and $79.7 million, respectively.

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11. Restructuring charges

Restructuring charges for each period were as follows:

	Nine months ended September 30,	
(in thousands)	2018	2017
Cost of revenue	$1,357	$458
Research and development	12,032	8,406
Sales and marketing	5,042	5,960
General and administrative	3,095	1,964
Total restructuring charges	$21,526	$16,788

First quarter 2018 restructuring

On January 2, 2018, the Company approved a restructuring plan to further reduce future operating expenses and better align resources around its long-term business strategy. The restructuring provided for a reduction of the Company's global workforce of approximately 18%, the closure of the Company's aerial group and the consolidation of certain leased office facilities. Under the first quarter 2018 restructuring plan, the Company recorded restructuring charges of $16.8 million, including $13.4 million related to severance and $3.4 million related to other charges.

The following table provides a summary of the Company’s restructuring activities for the nine months ended September 30, 2018 and the related liabilities recorded in accrued liabilities on the condensed consolidated balance sheet.

(in thousands)	Severance	Other	Total
Restructuring liability as of December 31, 2017	$ —	$—	$—
Restructuring charges	13,468	3,371	16,839
Cash paid	(11,584)	(1,840)	(13,424)
Non-cash reductions	(528)	(1,299)	(1,827)
Restructuring liability as of September 30, 2018	$ 1,356	$232	$1,588

First quarter 2017 restructuring

On March 15, 2017, the Company approved a restructuring plan to reduce future operating expenses and further align resources around its long-term business strategy. The restructuring provided for a reduction of the Company’s global workforce by approximately 17% and the consolidation of certain leased office facilities. Under the first quarter 2017 restructuring plan, the Company recorded restructuring charges of $21.5 million, including $10.3 million related to severance, and $11.2 million related to accelerated depreciation and other charges. The actions associated with the first quarter 2017 restructuring plan were substantially completed by the fourth quarter of 2017. While the Company anticipates that any additional charges related to this restructuring will be immaterial, actual results may differ from current estimates as it relates to the consolidation of certain leased office facilities.

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Notes to Condensed Consolidated Financial Statements

The following table provides a summary of the Company's restructuring activities for the nine months ended September 30, 2018 and the related liabilities recorded in accrued liabilities on the condensed consolidated balance sheet.

(in thousands)	Severance	Other	Total
Restructuring liability as of December 31, 2017	$ —	$3,550	$3,550
Restructuring charges	—	4,509	4,509
Cash paid	—	(2,457)	(2,457)
Non-cash charges	—	582	582
Restructuring liability as of September 30, 2018	$ —	$6,184	$6,184

Fourth quarter 2016 restructuring

On November 29, 2016, the Company approved a restructuring plan to reduce future operating expenses. The restructuring provided for a reduction of the Company's global workforce of approximately 15%, the closure of the Company's entertainment group to concentrate on its core business and the consolidation of certain leased office facilities. Under the fourth quarter 2016 restructuring plan, the Company recorded restructuring charges of $39.9 million, including $36.7 million related to severance, and $3.2 million related to accelerated depreciation and other charges. The actions associated with the fourth quarter 2016 restructuring plan were completed by March 31, 2017, with only small incremental charges recorded through September 30, 2018.

The following table provides a summary of the Company's restructuring activities for the nine months ended September 30, 2018 and the related liabilities recorded in accrued liabilities on the condensed consolidated balance sheet.

(in thousands)	Severance	Other	Total
Restructuring liability as of December 31, 2017	$ 400	$ 50	$450
Restructuring charges	151	—	151
Cash paid	(244)	—	(244)
Restructuring liability as of September 30, 2018	$ 307	$ 50	$357

First quarter 2016 restructuring

On January 12, 2016, the Company approved a restructuring plan that provided for a reduction in the Company's global workforce of approximately 7%. Under the first quarter 2016 restructuring plan, the Company recorded restructuring charges of $6.5 million in the first quarter of 2016, which primarily included cash-based severance costs. The Company completed this plan at the end of the first quarter of 2016 and all costs have been paid. No charges were recorded in periods after March 31, 2016.

GoPro, Inc.
Management’s Discussion and Analysis of Financial Condition and Results of Operations

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A)
Our MD&A is provided in addition to the accompanying condensed consolidated financial statements and accompanying notes to assist readers in understanding our results of operations, financial condition and cash flows. This MD&A is organized as follows:

- Overview. Discussion of our business and overall analysis of financial and other highlights affecting the Company in order to provide context for the remainder of MD&A.
- Results of Operations. Analysis of our financial results comparing the third quarter and first nine months of 2018 to 2017.
- Liquidity and Capital Resources. Analysis of changes in our balance sheets and cash flows, and discussion of our financial condition and potential sources of liquidity.
- Contractual Commitments. Overview of our contractual obligations, including expected payment schedule and indemnifications as of September 30, 2018.
- Critical Accounting Policies and Estimates. Accounting estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results and forecasts.
- Non-GAAP Financial Measures. A presentation of our results reconciling GAAP to non-GAAP adjusted measures.

The following discussion should be read in conjunction with our 2017 Annual Report and the condensed consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q of GoPro, Inc. and its subsidiaries (GoPro or we or the Company). Our MD&A contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding guidance, industry prospects, product and marketing plans, or future results of operations or financial position, made in this Quarterly Report on Form 10-Q are forward-looking. To identify forward-looking statements, we may use such words as “expect,” “anticipate,” “believe,” “may,” “will,” “estimate,” “continue,” “intend,” “target,” “goal,” “plan,” or variations of such words and similar expressions. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their date. If any of management's assumptions prove incorrect or should unanticipated circumstances arise, the Company's actual results could materially differ from those anticipated by such forward-looking statements. The differences could be caused by a number of factors or combination of factors including, but not limited to, those factors identified and detailed in Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q for the quarter ended September 30, 2018. Forward-looking statements include new product offering plans and key hardware and software features, research and development plans, marketing plans, plans for international expansion and revenue growth drivers, plans to reduce operating expense and drive profitability, plans to settle note conversion in cash, expectations regarding the volatility of the Company’s tax provision and resulting effective tax rate and projections of results of operations, and any discussion of the trends and other factors that drive our business and future results in Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations, and other sections of this Quarterly Report on Form 10-Q including but not limited to Item 1A Risk Factors. Readers are strongly encouraged to consider the foregoing including those factors when evaluating any forward-looking statements concerning the Company. The Company does not undertake any obligation to update any forward-looking statements in this Quarterly Report on Form 10-Q to reflect future events or developments.

Overview
GoPro helps the world capture and share itself in immersive and exciting ways. We are committed to developing solutions that create an easy, seamless experience for consumers to capture, create, and share engaging personal content. When consumers use our products and services, those products and services enable compelling, authentic content that organically increases awareness for GoPro, driving a virtuous cycle and a self-reinforcing demand for our products. We believe revenue growth may be driven by the introduction of new

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cameras, offerings, accessories and software applications. We believe new camera features and related services drive a replacement cycle and attract new users. Our investments in image stabilization, mobile editing and sharing solutions, auto-upload capabilities, local language user-interfaces and voice recognition in multiple languages drive the expansion of our total addressable market.

In the third quarter of 2018, we began shipping our new HERO7 line of cameras, including our newest flagship camera, HERO7 Black, which features HyperSmooth image stabilization, TimeWarp Video, live streaming, cloud connectivity, voice control and a touch display. HyperSmooth makes it easy to capture professional-looking, gimbal-like stabilized videos without a gimbal, while TimeWarp Video applies a high-speed, ‘magic-carpet-ride’ effect to videos. Live streaming enables users to share content in real time to Facebook, Twitch, YouTube, Vimeo and other platforms internationally. Our flagship HERO7 Black camera, powered by GoPro’s custom designed GP1 processor, is the most powerful and performance featured GoPro camera to date. We also began shipping our HERO7 Silver and HERO7 White cameras in the third quarter of 2018, which feature cloud connectivity, voice control and a touch display. We offer many professional-grade features with our current good-better-best camera offering with HERO7 White, HERO7 Silver and HERO7 Black. Our cameras are compatible with our ecosystem of mountable and wearable accessories, and feature automatic uploading capabilities for photos and videos to GoPro Plus, our premium cloud-based solution that serves as a protection plan and enables subscribers to easily access, edit, store and share their content. As of September 30, 2018, we have approximately 185,000 GoPro Plus subscribers, which represents a 16% increase sequentially and a 39% increase year-over-year. All of our cameras are also compatible with the GoPro App, our mobile experience that seamlessly uploads a user’s GoPro photos and video clips to his or her smartphone and transforms them into a ready-to-share video through GoPro QuikStories. Using GoPro QuikStories makes it simple for users to automatically create shareable video edits complete with music, effects and transitions.

Our product offerings also include our waterproof 360-degree spherical camera, Fusion, and our drone and stabilization solution, Karma.

The following is a summary of measures presented in our condensed consolidated financial statements and key metrics used to evaluate our business, measure our performance, develop financial forecasts and make strategic decisions.

(units and dollars in thousands, except per share amounts)	Q3 2018	Q2 2018	Q3 2017	% Change Q3 2018 vs. Q2 2018	Q3 2018 vs. Q3 2017
Revenue	$285,936	$282,677	$329,805	1 %	(13)%
Camera units shipped [1]	1,095	1,071	1,144	2 %	(4)%
Gross margin [2]	31.8 %	29.5 %	39.6 %	230 bps	(780) bps
Operating expenses	$112,386	$114,205	$122,497	(2)%	(8)%
Net income (loss)	$(27,089)	$(37,269)	$14,661	(27)%	(285)%
Diluted net income (loss) per share	$(0.19)	$(0.27)	$0.10	(30)%	(290)%
Cash provided by (used) in operations	$9,763	$(1,048)	$55,523	(1,032)%	(82)%
Other financial information:					
Adjusted EBITDA [3]	$6,205	$(8,697)	$35,725	(171)%	(83)%
Non-GAAP net income (loss) [4]	$(6,058)	$(20,843)	$21,149	(71)%	(129)%
Non-GAAP income (loss) per share	$(0.04)	$(0.15)	$0.15	(73)%	(129)%

(1) Represents the number of camera units that are shipped during a reporting period, including camera units that are shipped with drones, net of any returns. Camera units shipped does not include drones sold without a camera, mounts or accessories.

(2) One basis point (bps) is equal to 1/100th of 1%.

(3) We define adjusted EBITDA as net income (loss) adjusted to exclude the impact of: provision for income taxes, interest income, interest expense, depreciation and amortization, POP display amortization, stock-based compensation, impairment charges and restructuring costs.

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(4) We define non-GAAP net income (loss) as net income (loss) adjusted to exclude stock-based compensation, acquisition-related costs, restructuring costs, non-cash interest expense and income tax adjustments. Acquisition-related costs include amortization and impairment write-downs of acquired intangible assets (if applicable) as well as third-party transaction costs for legal and other professional services.

Reconciliations of non-GAAP adjusted measures to the most directly comparable GAAP measures are presented under Non-GAAP Financial Measures below.

Third quarter 2018 financial performance

Revenue for the third quarter of 2018 was $285.9 million, a 13% decrease year-over-year from $329.8 million in the same period of 2017. Gross margin in the third quarter of 2018 was 31.8%, down from 39.6% a year ago. Revenue and gross margin were both impacted by lower price points for each of our good, better, best product offerings versus the third quarter of 2017. Additionally, aerial and accessories revenue decreased $22.3 million compared to the third quarter of 2017. Camera units shipped in the third quarter of 2018 of 1.09 million units was slightly down compared to 1.14 million units in the same period of 2017. Our third quarter operating expenses of $112.4 million decreased 8% year-over-year, despite increasing our advertising expenses $12.5 million, resulting from our continued focus on cost management, expansion into lower cost jurisdictions and the financial benefits recognized from our restructuring actions.

Net loss in the third quarter of 2018 was $27.1 million, or $0.19 per share, a decrease of $41.8 million, when compared to 2017. For the third quarter of 2018, non-GAAP net loss was $6.1 million, or $0.04 per share, and adjusted EBITDA increased to a positive $6.2 million. Non-GAAP net loss excludes, where applicable, the effects of stock-based compensation, acquisition-related costs, restructuring costs, non-cash interest expense and the tax impact of these items. See Results of Operations and Non-GAAP Financial Measures below for additional information.

Factors affecting performance

We believe that our future success will be dependent on many factors, including those further discussed below. While these areas represent opportunities for us, they also represent challenges and risks that we must successfully address in order to continue the growth of our business and improve our results of operations.

Driving profitability through improved efficiency, lower costs and better execution. We incurred material operating losses in 2016, 2017 and in the first nine months of 2018. Our restructuring actions have significantly reduced our operating expenses in 2017 and in the first nine months of 2018 resulting in a flatter, more efficient global organization that has allowed for improved communication and alignment among our functional teams. If we are unable to generate adequate revenue growth, and continue to manage our expenses, we may incur significant losses in the future and may not be able to achieve profitability. Refer to our Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q for the quarter ended September 30, 2018.

Investing in research and development and enhancing our customer experience. Our performance is significantly dependent on the investments we make in research and development, including our ability to attract and retain highly skilled and experienced research and development personnel. We expect the timing of new product releases to continue to have a significant impact on our revenue and we must continually develop and introduce innovative new cameras, mobile applications and other new products and services. We plan to further build upon our integrated mobile and cloud-based storytelling solutions and subscription offerings in future periods. Our investments, including marketing and advertising expenses, may not successfully drive increased revenue and our users may not adopt our new offerings. If we fail to innovate and enhance our brand, our products, our integrated storytelling solution and the value proposition of our subscriptions, our market position and revenue will be adversely affected. Further, we have incurred substantial research and development expenses and if our efforts are not successful, we may not recover the value of these investments.

Growing our total addressable market globally. We continue to believe that international markets represent a significant growth opportunity for GoPro. Revenue from outside the United States comprised 63% of total revenue in the first nine months of 2018. While the total market for digital cameras has declined in recent periods, as smartphone and tablet camera quality has improved, we continue to believe that our consumers’ differentiated use of GoPro cameras, our integrated storytelling solution, our continued innovation of product features desired by our users, and our brand, all help insulate our business from many of the negative trends facing this category. However, we expect that the markets in which we conduct our business will remain highly competitive. We plan to

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increase our presence internationally through the active promotion of our brand, the creation and cultivation of regional strategic and marketing partnerships, the continued introduction of localized products in international markets with region specific marketing, and an investment focus on the biggest opportunities in both Europe and the Asia Pacific region.

Our growth also depends on expanding our total addressable market with our updated subscription service, GoPro Plus, as well as other services and capture solutions, including spherical, which are all resource intensive initiatives in highly competitive markets. If we are not successful in penetrating additional markets, we might not be able to grow revenue and we may not recognize benefits from our investment in new areas.

Marketing the improved GoPro experience to our extended community. We intend to continue investing resources in our marketing, advertising and brand management efforts. Historically, our growth has largely been fueled by the adoption of our products by people looking to self-capture images of themselves participating in exciting physical activities. Our future growth depends on continuing to reach, expand and re-engage with this core user base and grow it. We believe that consumers in our core user base in many markets are not familiar with our brand and products and believe there is an opportunity for GoPro to expand awareness through a range of advertising and promotional programs and campaigns, including social media. In addition, we may look to expand our user base to include a broader group of consumers. Sales and marketing investments will often occur in advance of any sales benefits from these activities, and it may be difficult for us to determine if we are efficiently allocating our resources in this area.

Seasonality. Historically, we have experienced the highest levels of revenue in the fourth quarter of the year, coinciding with the holiday shopping season, particularly in the United States and Europe. While we have implemented operational changes aimed at reducing the impact of fourth quarter seasonality on full year performance, timely and effective product introductions and forecasting, whether just prior to the holiday season or otherwise, are critical to our operations and financial performance.

Results of Operations

The following table sets forth the components of our condensed consolidated statements of operations for each of the periods presented, and each component as a percentage of revenue:

	Three months ended September 30,				Nine months ended September 30,			
(dollars in thousands)	2018		2017		2018		2017	
Revenue	$285,936	100 %	$329,805	100 %	$770,959	100 %	$844,945	100 %
Cost of revenue	194,904	68	199,259	60	551,642	72	540,201	64
Gross profit	91,032	32	130,546	40	219,317	28	304,744	36
Operating expenses:								
Research and development	41,157	14	55,098	17	130,361	17	176,761	21
Sales and marketing	55,871	20	46,622	14	165,297	21	171,156	20
General and administrative	15,358	5	20,777	6	50,588	7	61,976	7
Total operating expenses	112,386	39	122,497	37	346,246	45	409,893	48
Operating income (loss)	(21,354)	(7)	8,049	3	(126,929)	(17)	(105,149)	(12)
Other income (expense):								
Interest expense	(4,616)	(2)	(4,554)	(1)	(13,804)	(1)	(9,152)	(1)
Other income (expense), net	661	—	322	—	(268)	—	705	—
Total other expense, net	(3,955)	(2)	(4,232)	(1)	(14,072)	(1)	(8,447)	(1)
Income (loss) before income taxes	(25,309)	(9)	3,817	2	(141,001)	(18)	(113,596)	(13)
Income tax (benefit) expense	1,780	1	(10,844)	(3)	(296)	—	13,429	2
Net income (loss)	$(27,089)	(10)%	$14,661	5 %	$(140,705)	(18)%	$(127,025)	(15)%

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Revenue

	Three months ended September 30,			Nine months ended September 30,		
(camera units and dollars in thousands)	2018	2017	% Change	2018	2017	% Change
Camera units shipped	1,095	1,144	(4)%	2,924	2,942	(1)%
Direct channel	$133,726	$171,018	(22)%	$378,752	$455,455	(17)%
Percentage of revenue	47 %	52 %		49 %	54 %	
Distribution channel	$152,210	$158,787	(4)%	$392,207	$389,490	1 %
Percentage of revenue	53 %	48 %		51 %	46 %	
Total revenue	$285,936	$329,805	(13)%	$770,959	$844,945	(9)%
Americas	$119,524	$163,430	(27)%	$341,576	$416,164	(18)%
Percentage of revenue	42 %	50 %		44 %	49 %	
Europe, Middle East and Africa (EMEA)	$96,056	$97,179	(1)%	$249,207	$245,256	2 %
Percentage of revenue	34 %	29 %		32 %	29 %	
Asia and Pacific (APAC)	$70,356	$69,196	2 %	$180,176	$183,525	(2)%
Percentage of revenue	25 %	21 %		23 %	22 %	
Total revenue	$285,936	$329,805	(13)%	$770,959	$844,945	(9)%

Our camera units shipped during the third quarter of 2018 was slightly down at 1.09 million units compared to 1.14 million units in the same period in 2017, while our camera units shipped during the first nine months of 2018 were relatively flat at 2.92 million units compared to the same period in 2017. The year-over-year decrease in revenue for the third quarter and first nine months of 2018 were primarily attributable to lower camera revenue, reflecting lower retail price points for our HERO7 line of cameras relative to our camera offerings in the prior year. In the third quarter and first nine months of 2018, camera units over $399 represented 62% of our sales mix, compared to 85% and 80% in the same periods in 2017, respectively. Additionally, aerial and accessories revenue decreased $22.3 million and $67.0 million, respectively, compared to the third quarter and first nine months of 2017. The decrease in aerial sales was expected as we continued to sell through our remaining Karma drone inventory following the announcement of our exit of the aerial business in the first quarter of 2018. All of these factors contributed to a lower average selling price in the third quarter and first nine months of 2018, which is defined as net revenue divided by camera units shipped.

Cost of revenue and gross margin

	Three months ended September 30,			Nine months ended September 30,		
(dollars in thousands)	2018	2017	% Change	2018	2017	% Change
Cost of revenue	$190,892	$197,579	(3)%	$539,527	$534,763	1 %
Stock-based compensation	534	445	20 %	1,406	1,355	4 %
Acquisition-related costs	3,363	1,195	181 %	9,352	3,625	158 %
Restructuring costs	115	40	188 %	1,357	458	196 %
Total cost of revenue	$194,904	$199,259	(2)%	$551,642	$540,201	2 %
Gross margin	31.8 %	39.6 %		28.4 %	36.1 %	

Gross margin of 31.8% in the third quarter of 2018 decreased from 39.6% in 2017, or (780) bps, reflecting our decrease in average selling price, (520) bps, and temporarily higher prices associated with component supply shortages, (180) bps.

Gross margin of 28.4% in the first nine months of 2018 decreased from 36.1% in the first nine months of 2017, or (770) bps, reflecting our decrease in average selling price, (500) bps, higher purchase order commitment charges

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related to Karma and related accessories, (170) bps, and the sale of previously discontinued and written off cameras in the first quarter of 2017, (92) bps.

Research and development

(dollars in thousands)	Three months ended September 30, 2018	2017	% Change	Nine months ended September 30, 2018	2017	% Change
Research and development	$33,892	$47,160	(28)%	$103,387	$148,288	(30)%
Stock-based compensation	4,977	5,967	(17)%	14,942	17,039	(12)%
Acquisition-related costs	—	946	(100)%	—	3,028	(100)%
Restructuring costs	2,288	1,025	123 %	12,032	8,406	43 %
Total research and development	$41,157	$55,098	(25)%	$130,361	$176,761	(26)%
Percentage of revenue	14.4 %	16.7 %		16.9 %	20.9 %	

The year-over-year decrease of $13.9 million, or 25%, in total research and development expenses in the third quarter of 2018 compared to 2017 reflected a $10.4 million decrease in cash-based personnel-related costs due to a reduction in global research and development headcount, a $1.8 million decrease in professional services costs, a $1.0 million decrease in stock-based compensation and a $1.0 million decrease in amortization of intangibles due to a reclassification to cost of revenue.

The year-over-year decrease of $46.4 million, or 26%, in total research and development expenses in the first nine months of 2018 compared to 2017 reflected a $30.5 million decrease in cash-based personnel-related costs due to a reduction in global research and development headcount, a $7.8 million decrease in depreciation and other supporting overhead expenses, a $5.3 million decrease in professional services costs, a $3.0 million decrease in amortization of intangibles due to a reclassification to cost of revenue and a $2.1 million decrease in stock-based compensation.

Research and development headcount has decreased 33% from September 30, 2017, principally as a result of our exit of the aerial business included in our restructuring actions. See Restructuring costs below for additional information regarding restructuring charges recorded in 2018 and 2017.

Sales and marketing

(dollars in thousands)	Three months ended September 30, 2018	2017	% Change	Nine months ended September 30, 2018	2017	% Change
Sales and marketing	$52,247	$43,656	20 %	$152,766	$157,901	(3)%
Stock-based compensation	2,429	2,609	(7)%	7,489	7,295	3 %
Restructuring costs	1,195	357	235 %	5,042	5,960	(15)%
Total sales and marketing	$55,871	$46,622	20 %	$165,297	$171,156	(3)%
Percentage of revenue	19.5 %	14.1 %		21.4 %	20.3 %	

The year-over-year increase of $9.2 million, or 20%, in total sales and marketing expenses in the third quarter of 2018 compared to 2017 reflected an $11.2 million increase in advertising and marketing activities and a $1.0 million increase in consulting and professional services costs, partially offset by a $2.9 million decrease in cash-based personnel-related costs due to a reduction in global sales and marketing headcount and $0.8 million decrease in travel and entertainment.

The year-over-year decrease of $5.9 million, or 3%, in total sales and marketing expenses in the first nine months of 2018 compared to 2017 reflected a $9.5 million decrease in cash-based personnel-related costs due to a reduction in global sales and marketing headcount, a $2.1 million decrease in travel and entertainment and a $2.2 million decrease in consulting and outside professional service costs, partially offset by an $8.9 million increase in advertising and marketing activities.

Sales and marketing headcount has decreased 23% from September 30, 2017 principally as a result of our

restructuring activities. See Restructuring costs below for additional information regarding restructuring charges recorded in 2018 and 2017.

General and administrative

(dollars in thousands)	Three months ended September 30, 2018	2017	% Change	Nine months ended September 30, 2018	2017	% Change
General and administrative	$12,543	$17,368	(28)%	$40,156	$49,488	(19)%
Stock-based compensation	2,397	2,854	(16)%	7,334	10,546	(30)%
Acquisition-related costs	—	—	— %	3	(22)	(114)%
Restructuring costs	418	555	(25)%	3,095	1,964	58 %
Total general and administrative	$15,358	$20,777	(26)%	$50,588	$61,976	(18)%
Percentage of revenue	5.4 %	6.3 %		6.6 %	7.3 %	

The year-over-year decrease of $5.4 million, or 26%, in total general and administrative expenses in the third quarter of 2018 compared to 2017 reflected a $2.3 million decrease in cash-based personnel-related costs due to a reduction in global general and administrative headcount, a $1.3 million decrease in settlement charges and a $1.0 million reduction in research and development tax credits.

The year-over-year decrease of $11.4 million, or 18%, in total general and administrative expenses in the first nine months of 2018 compared to 2017 reflected a $5.8 million decrease in cash-based personnel-related costs due to a reduction in global general and administrative headcount, a $3.2 million decrease in stock-based compensation, a $1.3 million decrease in settlement charges and a $1.0 million reduction in research and development tax credits.

General and administrative headcount has decreased 17% from September 30, 2017, principally as a result of our restructuring actions. See Restructuring costs below for additional information regarding restructuring charges recorded in 2018 and 2017.

Restructuring costs

First quarter 2018 restructuring plan. On January 2, 2018, we approved a restructuring plan to further reduce future operating expenses and better align resources around our long-term business strategy. The restructuring provided for a reduction of our global workforce of approximately 18%, the closure of our aerial group and the consolidation of certain leased office facilities. Under the first quarter 2018 restructuring plan, we recorded restructuring charges of $16.8 million, including $13.4 million related to severance and $3.4 million related to accelerated depreciation and other charges.

First quarter 2017 restructuring plan. On March 15, 2017, we approved a restructuring plan that provided for a reduction of our global workforce by approximately 17% and the consolidation of certain leased office facilities. Under the first quarter 2017 restructuring plan, we recorded restructuring charges of $21.5 million, including $10.3 million related to severance, and $11.2 million related to accelerated depreciation and other charges. The actions associated with the first quarter 2017 restructuring plan were substantially completed by the fourth quarter of 2017. While we anticipate that any additional charges related to this restructuring will be immaterial, actual results may differ from current estimates as it relates to the consolidation of certain leased office facilities.

Fourth quarter 2016 restructuring plan. On November 29, 2016, we approved a restructuring plan that provided for a reduction in our global workforce of approximately 15%, the closure of our entertainment group and the consolidation of certain leased office facilities. Under the fourth quarter 2016 restructuring plan, we recorded restructuring charges of $39.9 million, including $36.7 million related to severance, and $3.2 million related to accelerated depreciation and other charges. The actions associated with the fourth quarter 2016 restructuring plan were completed by March 31, 2017, with only small incremental charges recorded through September 30, 2018.

First quarter 2016 restructuring plan. On January 12, 2016, we approved a restructuring plan that provided for a reduction in our global workforce of approximately 7%. Under the first quarter 2016 restructuring plan, we recorded restructuring charges of $6.5 million in the first quarter of 2016, which primarily included cash-based

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severance costs. We completed this plan at the end of the first quarter of 2016 and all costs have been paid. No charges were recorded in periods after March 31, 2016.
See Note 11 Restructuring charges, to the Notes to Condensed Consolidated Financial Statements above.
Other income (expense)

	Three months ended September 30,			Nine months ended September 30,		
(dollars in thousands)	2018	2017	% Change	2018	2017	% Change
Interest expense	$(4,616)	$(4,554)	1 %	$(13,804)	$(9,152)	51 %
Other income (expense), net	661	322	105 %	(268)	705	(138)%
Total other expense, net	$(3,955)	$(4,232)	(7)%	$(14,072)	$(8,447)	67 %

Total other expense, net decreased $0.3 million in the third quarter of 2018 compared to the same period in 2017 due to foreign exchange rate-based transaction gains and losses and a value added tax refund.
Total other expense, net increased $5.6 million in the first nine months of 2018 compared to the same period in 2017 due to interest expense related to our Convertible Notes.
Income taxes

	Three months ended September 30,			Nine months ended September 30,		
(dollars in thousands)	2018	2017	% Change	2018	2017	% Change
Income tax (benefit) expense	$1,780	$(10,844)	(116)%	$(296)	$13,429	(102)%
Effective tax rate	(7.0)%	(284.1)%		0.2 %	(11.8)%	

We recorded an income tax expense of $1.8 million for the three months ended September 30, 2018 on a pre-tax net loss of $25.3 million, which resulted in a negative effective tax rate of 7.0%. Our income tax expense for the three months ended September 30, 2018 was primarily composed of $1.5 million of tax expense incurred on pre-tax income in profitable foreign jurisdictions, one-time items that included $7.0 million of net non-deductible equity tax expense and $0.4 million of tax expense related to foreign provision to return adjustments, partially offset by a $1.1 million tax benefit relating to restructuring expense and a $6.3 million net decrease in the valuation allowance. We recorded an income tax benefit of $0.3 million for the nine months ended September 30, 2018 on a pre-tax net loss of $141.0 million, which resulted in an effective tax rate of 0.2%. Our income tax benefit for the nine months ended September 30, 2018 was composed of $2.4 million of tax expenses incurred on pre-tax income in profitable foreign jurisdictions, one-time items that included $10.9 million of tax benefit primarily relating to the conclusion of the IRS audit and the release of uncertain tax positions, $9.6 million of net non-deductible equity tax expense, $5.4 million of tax benefit relating to restructuring expenses, $0.6 million of uncertain tax position interest expense and $0.3 million tax expense related to foreign provision to return adjustments, offset by $3.1 million net increase in the valuation allowance.
For the three months ended September 30, 2017, we recorded an income tax benefit of $10.8 million on a pre-tax net income of $3.8 million, which resulted in a negative effective tax rate of 284.1%. Our income tax benefit for the three months ended September 30, 2017 related primarily to foreign taxes and a cumulative adjustment due to the change in our estimated annual tax rate. We recorded an income tax provision of $13.4 million for the nine months ended September 30, 2017 on a pre-tax net loss of $113.6 million, which resulted in a negative effective tax rate of 11.8%. Our income tax provision in the first nine months of 2017 was principally composed of tax expenses incurred on pre-tax income in profitable foreign jurisdictions. Due to certain tax structure changes effective January 1, 2018, including the planned liquidation of the Company’s subsidiary, Woodman Labs Cayman, Inc., our tax provision and resulting effective tax rate for interim periods in 2018 and future years is expected to be subject to less volatility and fluctuation quarter over quarter than in 2017. Further, for both 2018 and 2017, while we incurred pre-tax losses in the United States and certain lower-rate jurisdictions, we do not expect to recognize any tax benefits on pre-tax losses in

the United States due to a full valuation allowance recorded against our U.S. deferred tax assets (see Note 7 Income taxes, to the Notes to Condensed Consolidated Financial Statements above).

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During the nine months ended September 30, 2018, the Internal Revenue Service concluded its audit for the 2012 through 2015 tax years. The Closing Agreement was received on January 24, 2018 and we received an income tax refund of approximately $32.9 million, net of IRS adjustments, in February 2018. As a result, we recognized a reduction in gross unrecognized tax benefits of $26.0 million and an income tax benefit, net of valuation allowance, of approximately $2.6 million.

Future changes in our forecast annual income (loss) projections, tax rate changes, or discrete tax items could result in significant adjustments to quarterly income tax expense (benefit) in future periods.

Liquidity and Capital Resources
The following table presents selected financial information as of September 30, 2018 and December 31, 2017:

(dollars in thousands)	September 30, 2018	December 31, 2017
Cash and cash equivalents	$ 143,246	$ 202,504
Marketable securities	4,996	44,886
Total cash, cash equivalents and marketable securities	$ 148,242	$ 247,390
Percentage of total assets	22 %	29 %

Our primary source of cash is receipts from sales. Other sources of cash were from proceeds from employee participation in the employee stock purchase plan and the exercise of employee stock options and sublease income. The primary uses of cash are for inventory procurement, payroll-related expenses, general operating expenses, including advertising, marketing and office rent, purchases of property and equipment, and other costs of revenue.
As of September 30, 2018, our cash, cash equivalents and marketable securities of $148.2 million were down $99.1 million, or 40.1%, compared to December 31, 2017. The decrease was primarily due to payments on accounts payable and price protection charges related to price reductions in the fourth quarter of 2017 and first quarter of 2018. The net cash used in operating activities of $88.4 million as of September 30, 2018 was primarily due to the impact of price reductions in the first quarter of 2018. As of September 30, 2018, $43.9 million of cash was held by our foreign subsidiaries.
Convertible Notes
In April 2017, we issued $175.0 million aggregate principal amount of 3.50% Convertible Senior Notes in a private placement to purchasers for resale to qualified institutional buyers. The Notes mature on April 15, 2022, unless earlier repurchased or converted into shares of Class A common stock subject to certain conditions. The Notes are convertible into cash, shares of the Class A common stock, or a combination thereof, at our election, at an initial conversion rate of 94.0071 shares of common stock per $1,000 principal amount of the Notes, which is equivalent to an initial conversion price of approximately $10.64 per share of common stock, subject to adjustment. We pay interest on the Notes semi-annually in arrears on April 15 and October 15 of each year. Proceeds received from the issuance of the Notes were allocated between a liability component (long-term debt) and an equity component (additional paid-in capital). The fair value of the liability component was measured using rates determined for similar debt instruments without a conversion feature.
In connection with the Notes offering, we entered into a prepaid forward stock repurchase transaction agreement (Prepaid Forward) with a financial institution. Pursuant to the Prepaid Forward, we used approximately $78.0 million of the proceeds from the offering of the Notes to pay the prepayment amount. The aggregate number of shares of our Class A common stock underlying the Prepaid Forward is approximately 9.2 million shares. The expiration date for the Prepaid Forward is April 15, 2022, although it may be settled earlier in whole or in part. Upon settlement of the Prepaid Forward, at expiration or upon any early settlement, the forward counterparty will deliver to us the number of shares of Class A common stock underlying the Prepaid Forward or the portion thereof being settled early. The shares purchased under the Prepaid Forward were treated as treasury stock on the condensed consolidated balance sheet (and not outstanding for purposes of the calculation of basic and diluted earnings per share), but remain outstanding for

corporate law purposes, including for purposes of any future

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stockholders’ votes, until the forward counterparty delivers the shares underlying the Prepaid Forward to us. The net proceeds from the Convertible Senior Notes offering of approximately $91 million were used for general corporate purposes.

Liquidity

We believe, based on our most current projections, that our cash, cash equivalents and marketable securities, and amounts available under our credit facility, will be sufficient to address our working capital needs, capital expenditures, outstanding commitments and other liquidity requirements for at least the next 12 months.

- We expect that operating expenses and inventory purchases will constitute a material use of our cash balances. We intend to continue to manage our operating activities in line with our existing cash and available financial resources. We continue to believe that the restructuring actions and other cost saving initiatives we have taken will enable us to continue to significantly reduce our operating expenses to below $400 million on a non-GAAP basis for the full year 2018.
- We expect to spend significantly less on capital expenditures in 2018 compared to 2017. Our actual future capital requirements may vary materially from those currently planned and will depend on many factors, including our rate of revenue growth, the timing and extent of spending on research and development efforts and other business initiatives, the timing of new product introductions, market acceptance of our products and overall economic conditions, as set forth in our Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q for the quarter ended September 30, 2018.
- In March 2016, we entered into a credit agreement with a syndicate of banks that provided for a secured revolving credit facility under which we could borrow up to an aggregate of $250.0 million. Our credit facility terminates in March 2021. No borrowings have been made from the credit facility to date. (See Note 4 Financing Arrangements, in the Notes to Condensed Consolidated Financial Statements for additional information.)
- We have completed acquisitions in the past and we may evaluate additional possible acquisitions of, or strategic investments in, businesses, products and technologies that are complementary to our business, which may require the use of cash.

In the future, we may require additional funding to respond to business opportunities, challenges or unforeseen circumstances. If we are unable to obtain adequate financing under our credit facility, or other sources, when we require it, our ability to grow or support our business and to respond to business challenges could be significantly limited. In the event additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all.

Summary of Cash Flows

The following table summarizes our cash flows for the periods indicated:

	Nine months ended September 30,		
(in thousands)	2018	2017	% Change
Net cash provided by (used in):			
Operating activities	$(88,397)	$(93,843)	(6)%
Investing activities	31,900	(24,448)	(230)%
Financing activities	(2,707)	89,306	(103)%

Cash flows from operating activities

Cash used in operating activities of $88.4 million was primarily attributable to an adjusted net loss of $71.3 million (net loss adjusted for non-cash expenses of $69.4 million) and a net cash outflow of $17.1 million from changes in operating asset and liabilities. Cash outflow related to operating assets and liabilities consisted of decreases in accounts payable and other liabilities of $36.5 million due to payments of 2017 year-end liabilities, and a $36.8 million increase in accounts receivable from increased sales activity towards the end of the quarter, partially offset by a $32.2 million decrease in prepaid expenses and other assets, and a $27.3 million decrease in inventory.

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Cash flows from investing activities
Our primary investing activities consist of purchases and maturities of marketable securities, and purchases of property and equipment. Cash provided by investing activities was $31.9 million in the first nine months of 2018 resulting from the maturities of marketable securities of $55.0 million, partially offset by the purchases of marketable securities of $14.9 million, and $8.2 million for net purchases of property and equipment.
Cash flows from financing activities
Our primary financing activities consisted of the issuance of equity securities under our common stock plans. Cash used in financing activities was $2.7 million in the first nine months of 2018 resulting from $5.4 million in tax payments for net RSU settlements and $2.5 million for deferred acquisition-related payments, partially offset by $5.1 million received from stock purchases made through our ESPP and employee stock option exercises.
Contractual Commitments
Contractual obligations. See Note 4 Financing Arrangements, for discussion regarding our Convertible Senior Notes and Note 9 Commitments, contingencies and guarantees, for discussion regarding facility leases and other contractual commitments in the Notes to Condensed Consolidated Financial Statements.
Off-balance sheet arrangements. During the periods presented, we did not have any relationships with unconsolidated organizations or financial partnerships, such 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.
Indemnifications. We have entered into indemnification agreements with our directors and executives which require us to indemnify our directors and executives against liabilities that may arise by reason of their status or service. In addition, in the normal course of business, we enter into agreements that contain a variety of representations and warranties and provide for general indemnification. It is not possible to determine the maximum potential amount under these indemnification agreements due to our limited history with prior indemnification claims and the unique facts and circumstances involved in each particular agreement. To date, the payments we have made under these agreements have not had a material effect on our operating results, financial position or cash flows. However, we may record charges in the future as a result of these indemnification agreements.

Critical Accounting Policies and Estimates
Except for the accounting policies related to revenue recognition and intra-entity asset transfers that were updated as a result of adopting Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers and ASU 2016-16, Income Taxes — Intra-Entity Transfers of Assets Other Than Inventory, respectively, there have been no material changes to our critical accounting policies and estimates from those disclosed in our 2017 Annual Report.

Non-GAAP Financial Measures
We report net income (loss) and diluted net income (loss) per share in accordance with U.S. generally accepted accounting principles (GAAP) and on a non-GAAP basis. Additionally, we report non-GAAP adjusted EBITDA. We use non-GAAP financial measures to help us understand and evaluate our core operating performance and trends, to prepare and approve our annual budget, and to develop short-term and long-term operational plans. Our management uses, and believes that investors benefit from referring to, these non-GAAP financial measures in assessing our operating results. These non-GAAP financial measures should not be considered in isolation from, or as an alternative to, the measures prepared in accordance with GAAP, and are not based on any comprehensive set of accounting rules or principles. We believe that these non-GAAP measures, when read in conjunction with our GAAP financials, provide useful information to investors by facilitating:
- the comparability of our on-going operating results over the periods presented;

- the ability to identify trends in our underlying business; and
- the comparison of our operating results against analyst financial models and operating results of other public companies that supplement their GAAP results with non-GAAP financial measures.

These non-GAAP financial measures have limitations in that they do not reflect all of the amounts associated with our results of operations as determined in accordance with GAAP. Some of these limitations are:

- adjusted EBITDA does not reflect tax payments that reduce cash available to us;
- adjusted EBITDA excludes depreciation and amortization and, although these are non-cash charges, the property and equipment being depreciated and amortized often will have to be replaced in the future, and adjusted EBITDA does not reflect any cash capital expenditure requirements for such replacements;
- adjusted EBITDA excludes the amortization of POP display assets because it is a non-cash charge, and is treated similarly to depreciation of property and equipment and amortization of acquired intangible assets;
- adjusted EBITDA and non-GAAP net income (loss) exclude the impairment of intangible assets because it is a non-cash charge that is inconsistent in amount and frequency;
- adjusted EBITDA and non-GAAP net income (loss) exclude restructuring costs which primarily include severance-related costs, stock-based compensation expenses and facilities consolidation charges recorded in connection with restructuring actions announced in the first and fourth quarters of 2016, first quarter of 2017 and first quarter of 2018. These expenses were tied to unique circumstances related to organizational restructuring, do not reflect expected future operating expenses and do not contribute to a meaningful evaluation of current operating performance or comparisons to the operating performance in other periods;
- adjusted EBITDA and non-GAAP net income (loss) exclude stock-based compensation expense related to equity awards granted primarily to our workforce. We exclude stock-based compensation expense because we believe that the non-GAAP financial measures excluding this item provide meaningful supplemental information regarding operational performance. In particular, we note that companies calculate stock-based compensation expense for the variety of award types that they employ using different valuation methodologies and subjective assumptions. These non-cash charges are not factored into our internal evaluation of net income (loss) as we believe their inclusion would hinder our ability to assess core operational performance;
- non-GAAP net income (loss) excludes acquisition-related costs including the amortization of acquired intangible assets (primarily consisting of acquired technology), the impairment of acquired intangible assets (if applicable), as well as third-party transaction costs incurred for legal and other professional services. These costs are not factored into our evaluation of potential acquisitions, or of our performance after completion of the acquisitions, because these costs are not related to our core operating performance or reflective of ongoing operating results in the period, and the frequency and amount of such costs are inconsistent and vary significantly based on the timing and magnitude of our acquisition transactions and the maturities of the businesses being acquired;
- non-GAAP net income (loss) excludes non-cash interest expense. In connection with the issuance of the Convertible Senior Notes in April 2017, we are required to recognize non-cash interest expense in accordance with the authoritative accounting guidance for convertible debt that may be settled in cash;
- non-GAAP net income (loss) includes income tax adjustments. Beginning in the first quarter of 2017, we implemented a cash-based non-GAAP tax expense approach (based upon expected annual cash payments for income taxes) for evaluating operating performance as well as for planning and forecasting purposes. This non-GAAP tax approach eliminates the effects of period specific items, which can vary in size and frequency and does not necessarily reflect our long-term operations. Historically, we computed a non-GAAP tax rate based on non-GAAP pre-tax income on a quarterly basis, which considered the income tax effects of the adjustments above; and
- other companies may calculate these non-GAAP financial measures differently than we do, limiting their usefulness as comparative measures.

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The following tables present a reconciliation of net income (loss) to adjusted EBITDA:

(in thousands)	Three months ended September 30, 2018	June 30, 2018	September 30, 2017
Net income (loss)	$(27,089)	$(37,269)	$ 14,661
Income tax (benefit) expense	1,780	706	(10,844)
Interest expense, net	4,297	4,299	4,228
Depreciation and amortization	9,693	9,173	9,100
POP display amortization	3,171	3,611	4,728
Stock-based compensation	10,337	10,011	11,875
Restructuring costs	4,016	772	1,977
Adjusted EBITDA	$6,205	$(8,697)	$ 35,725

The following table present a reconciliation of net income (loss) to non-GAAP net income (loss):

(in thousands, except per share data)	Three months ended September 30, 2018	June 30, 2018	September 30, 2017
Net income (loss)	$(27,089)	$(37,269)	$ 14,661
Stock-based compensation	10,337	10,011	11,875
Acquisition-related costs	3,363	3,334	2,141
Restructuring costs	4,016	772	1,977
Non-cash interest expense	2,036	2,018	1,836
Income tax adjustments	1,279	291	(11,341)
Non-GAAP net income (loss)	$(6,058)	$(20,843)	$ 21,149
Non-GAAP income (loss) per share	$(0.04)	$(0.15)	$ 0.15
GAAP shares for diluted net income (loss) per share	140,072	139,166	136,236
Add: effect of potentially dilutive shares	—	—	4,052
Non-GAAP shares for diluted net income (loss) per share	140,072	139,166	140,288

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The fair value of our Senior Convertible Notes is subject to interest rate risk, market risk and other factors due to the convertible feature. The fair value of the Notes will generally increase as interest rates fall and decrease as interest rates rise. In addition, the fair value of the Notes will generally increase as our Class A common stock price increases and will generally decrease as the common stock price declines. The interest and market value changes affect the fair value of the Notes but do not impact our financial position, cash flows or results of operations due to the fixed nature of the debt obligation.

There have been no other material changes to our market risk during the nine months ended September 30, 2018. Refer to our market risk disclosures set forth in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk of our 2017 Annual Report.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company’s management, with the participation of the Company’s principal executive officer and principal financial officer, has evaluated the effectiveness of the Company’s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (Exchange Act)), as of September 30, 2018. Based on such evaluation, the Company’s principal executive officer and principal financial officer have concluded that, as of September 30, 2018, the Company’s disclosure controls and procedures were effective to ensure that information required to be disclosed in the Company’s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to the Company’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the three months ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Shareholder class action lawsuits

On January 25, 2016, a purported shareholder class action lawsuit was filed in the Superior Court of the State of California, County of San Mateo, against the Company, certain of its current and former directors and executive officers and underwriters of the Company's IPO ("Defendants"). The complaint purported to bring suit on behalf of shareholders who purchased the Company's stock pursuant or traceable to the Registration Statement and Prospectus issued in connection with the Company's IPO and alleged claims under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933. The suit sought unspecified damages and other relief. A similar complaint was filed on May 13, 2016, and consolidated on June 7, 2016. Defendants filed a demurrer (motion to dismiss) to the consolidated action. On July 13, 2016, the court sustained the demurrer dismissing the complaint with leave to amend the complaint. The plaintiff filed an amended complaint on October 7, 2016. Defendants filed a demurrer to the amended complaint on October 28, 2016. On December 16, 2016, the court overruled the demurrer with respect to the Section 11 and 15 claims and sustained the demurrer in part and overruled the demurrer in part with respect to the Section 12(a)(2) claim. Defendants answered the amended complaint on January 3, 2017. On November 20, 2017, the parties reached an agreement in principle to settle the action. The court entered final judgment and an order granting final approval of the settlement on July 27, 2018.

On November 16, 2016, a purported shareholder class action lawsuit (the "2016 Shareholder Class Action") was filed in the U.S. District Court for the Northern District of California against the Company and Mr. Woodman, our Chairman and CEO, Brian McGee, our CFO, and Anthony Bates, our former President ("Defendants"). The complaint purports to bring suit on behalf of shareholders who purchased the Company's publicly traded securities between September 19, 2016 and November 4, 2016. The complaint purports to allege that Defendants made false and misleading statements about the Company's business, operations and prospects in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and seeks unspecified compensatory damages, fees and costs. On February 6, 2017, the court appointed lead plaintiff and lead counsel. On March 14, 2017, the lead plaintiff filed an amended complaint against the Company and certain of its officers ("GoPro Defendants") on behalf of shareholders who purchased the Company's publicly traded securities between September 19, 2016 and November 8, 2016. On April 13, 2017, the GoPro Defendants filed a motion to dismiss the amended complaint. On July 26, 2017, the court denied that motion and directed plaintiff to amend its complaint to add all defendants the plaintiff intended to sue. On August 4, 2017, plaintiff filed a second amended complaint, which Defendants answered on September 8, 2017. On September 11, 2018 the parties participated in a mediation session and following the mediation reached an agreement in principle to settle the action. The settlement, which is subject to final documentation and the approval of the Court, among other conditions, will be funded entirely by the Company's insurance carriers.

On November 8, 2017, a purported shareholder derivative lawsuit was filed in the U.S. District Court for the Northern District of California against certain of GoPro's current and former directors and executive officers and naming the Company as a nominal defendant. The action is based on allegations similar to those in the 2016 Shareholder Class Action and asserts causes of action against the individual defendants for breach of fiduciary duty for allegedly disseminating false and misleading information, breach of fiduciary duty for allegedly misappropriating information and for insider stock sales, unjust enrichment, violation of Section 25402 of the California Corporations Code, and for contribution and indemnification. On January 4, 2018, the court signed an order relating this case to the 2016 Shareholder Class Action. On January 22, 2018, defendants filed a motion to dismiss for lack of subject matter jurisdiction and improper forum. Before briefing on that motion was complete, the plaintiff voluntarily dismissed the action on February 22, 2018.

Beginning on January 9, 2018, the first of four purported shareholder class action lawsuits (the "2018 Shareholder Class Action") were filed in the U.S. District Court for the Northern District of California against the Company, Mr. Woodman, and Mr. McGee. Similar complaints were filed on January 11, 2018 and January 24, 2018. On April 20, 2018, the court consolidated the four cases and appointed lead plaintiff and lead counsel. On June 18, 2018, plaintiffs filed their Consolidated Amended Complaint (the "Complaint"). The Complaint purports to bring suit on behalf of shareholders who purchased the Company's publicly traded securities between November 2, 2017 and

January 5, 2018. The Complaint adds Mr. Prober, GoPro's former COO, as a defendant (together with GoPro, Mr. Woodman and Mr. McGee ("Defendants")), and purports to allege that Defendants made false and misleading statements about the Company's business, operations and prospects in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "1934 Act"), asserts claims under Section 20A of the 1934 Act against Mr. Woodman and Mr. McGee, and seeks unspecified compensatory damages, fees and costs. Defendants filed a motion to dismiss the Complaint on August 17, 2018 and a hearing on the motion to dismiss is scheduled for November 5, 2018.

On February 13, 2018 and February 27, 2018, two purported shareholder derivative lawsuits (the "Derivative Actions") were filed in the U.S. District Court for the Northern District of California against certain of GoPro's current and former directors and executive officers and naming the Company as a nominal defendant. The Derivative Actions are based on allegations similar to those in both the 2016 Shareholder Class Action and the 2018 Shareholder Class Actions and assert causes of action against the individual defendants for breach of fiduciary duty, and for making false and misleading statements about the Company's business, operations and prospects in violation of Sections 10(b) and 14(a) of the Securities Exchange Act of 1934. Plaintiffs seek corporate reforms, disgorgement of profits from stock sales, and fees and costs. On March 15, 2018, the court signed orders relating the Derivative Actions to the 2016 Shareholder Class Action. The court consolidated the Derivative Actions on April 6, 2018. On May 8, 2018, the court stayed the Derivative Actions pending resolution of the 2016 Shareholder Class Action or commencement of any shareholder derivative action alleging substantially the same facts as those in the Derivative Actions, whichever occurs first.

On July 30, 2018, the Company received a letter (the "De Nicola Demand") purportedly sent on behalf of six shareholders, Giuseppe De Nicola, Junhee Lee, Alessandro Lobascio, Enechi Abolle, Joubin Hanaie, and Reid Nelson, alleging that between 2016 and 2018, the Company's directors and officers made false and misleading statements about the Company's business, operations and prospects. On September 4, 2018, and while the Company was still evaluating the De Nicola Demand, three of the shareholders filed an action in California Superior Court, County of San Mateo (the "De Nicola Action"). The De Nicola Action is a purported derivative action against certain of GoPro's current and former directors and executive officers and naming the Company as a nominal defendant. The complaint alleges that GoPro's board wrongfully refused the De Nicola Demand and asserts causes of action against the individual defendants for breach of fiduciary duty, unjust enrichment, waste and insider selling based on allegations similar to those in both the 2016 Shareholder Class Action and the 2018 Shareholder Class Action. Plaintiffs seek corporate reforms, disgorgement of profits from stock sales, and fees and costs. The time for defendants to answer the complaint has not yet passed.

We are currently, and in the future, may continue to be subject to litigation, claims and assertions incidental to our business, including patent infringement litigation and product liability claims, as well as other litigation of a non-material nature in the ordinary course of business. Due to inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of these matters. We are unable at this time to determine whether the outcome of the litigation would have a material effect on our business, financial condition, results of operations or cash flows.

Item 1A. Risk Factors

The risks described in Risk Factors in our 2017 Annual Report, and as supplemented below, could materially and adversely affect our business, financial condition and results of operations. We do not believe any of the updates below constitute material changes from the risk factors previously disclosed in our 2017 Annual Report. These risk factors do not identify all risks that we face; our operations could also be affected by factors that are not presently known to us or that we currently consider to be immaterial to our operations. In that event, the trading price of our shares may decline, and you may lose part or all of your investment.

Risks related to our business and industry

We may not be able to achieve revenue growth or profitability in the future.

Since 2015, our revenue has declined in each of the two succeeding years. Our historical results should not be considered as indicative of our future performance. For example, our annual revenue grew rapidly from $985.7 million in 2013 to $1.62 billion in 2015 and then declined to $1.185 billion and $1.180 billion in 2016 and 2017,

respectively. In future periods, we could continue to experience declines in revenue, or revenue could grow more slowly than we expect, which could have a material negative effect on our future operating results.
In addition, we incurred substantial operating losses of $126.9 million and $105.1 million for the first nine months of 2018 and 2017, respectively. We also incurred a substantial operating loss of $163.5 million and $373.0 million for the full year 2017 and 2016, respectively, as compared to operating income of $54.7 million for the full year 2015. Lower levels of revenue or higher levels of operating expense in future periods may result in additional losses or limited profitability. In the first quarter of 2018, we implemented a company-wide restructuring of our business resulting in a reduction in our global workforce and the elimination of certain open positions, consolidation of certain leased office facilities, as well as the elimination of several high-cost initiatives, including the closure of our aerial products business, in order to focus our resources on our core hardware camera and software business. We previously implemented company-wide restructurings of our business in the first and fourth quarters of 2016, and the first quarter of 2017, in order to focus our resources on our hardware and integrated storytelling solution, and the consolidation of certain leased office facilities. We may not realize the cost savings expected from these actions. We may continue to incur significant losses in the future for a number of reasons, including other risks described in this Quarterly Report on Form 10-Q and in our 2017 Annual Report, and we may encounter unforeseen expenses, difficulties, complications, delays and other unknown factors.
Our future growth depends in part on further penetrating our total addressable market, and we may not be successful in doing so.
Our growth historically has largely been fueled by the adoption of our products by people looking to self-capture images of themselves participating in exciting physical activities. We believe that our future growth depends on continuing to reach and expand our core community of users, followers and fans, and then utilizing that energized community as brand ambassadors to an extended community. We believe that in order to expand our market, we must provide both innovative and easy-to-use products, as well as intuitive and simple software tools that enable effortless sharing of content, with the smartphone central to the GoPro experience. We believe our subscription offerings will increase our total addressable market, but we cannot be certain that these efforts will be successful. We may not be able to expand our market through this strategy on a timely basis, or at all, and we may not be successful in providing tools that our users adopt or believe are easy to use.
In the first quarter of 2018 in the United States, we launched an updated GoPro PLUS subscription service which now includes our “You Break It, We Replace It” camera replacement and released updated versions of our GoPro and Quik mobile applications.
In the third quarter of 2018, we began shipping our new HERO7 line of cameras, including our newest flagship camera, HERO7 Black, which features HyperSmooth image stabilization, TimeWarp Video, live streaming, cloud connectivity, voice control and a touch display. We also began shipping our HERO7 Silver and HERO7 White cameras in the third quarter of 2018, which feature cloud connectivity, voice control and a touch display. We plan to further build upon our integrated storytelling solution in future periods, and our investments in this solution, including marketing and advertising expenses, may not successfully drive increased sales of our products and our users may not adopt our new offerings. If we are not successful in broadening our user base with our integrated solution, our future revenue growth will be negatively affected, and we may not recognize benefits from our investments in the various components of our storytelling solution, and the marketing, sales and advertising costs to promote our solution.
Our growth also depends on expanding our market with new capture perspectives, including spherical, which is a resource-intensive initiative in a highly competitive market. While we are investing resources, including in software development, sales and marketing, to reach these expanded and new consumer markets, we cannot be assured that we will be successful in doing so. If we are not successful in penetrating additional markets, we might not be able to grow our revenue and we may not recognize benefits from our investment in new areas. For example, we made significant investments in the aerial market, but decided in the first quarter of 2018 to close our aerial business in light of difficult market conditions and margin challenges. Moving forward, we expect to sell our remaining inventory of Karma drones, which may not be successful, depending on consumer demand for a product that is end of life.

To remain competitive and stimulate consumer demand, we must effectively manage product introductions, product transitions, product pricing and marketing.

We believe that we must continually develop and introduce new products, enhance our existing products and effectively stimulate customer demand for new and upgraded products to maintain or increase our revenue.

The success of new product introductions depends on a number of factors including, but not limited to, timely and successful research and development, pricing, market and consumer acceptance, effective forecasting and management of product demand, purchase commitments and inventory levels, availability of products in appropriate quantities to meet anticipated demand, ability to obtain timely and adequate delivery of components for our new products from third-party suppliers, management of any changes in major component suppliers, management of manufacturing and supply costs, management of risks associated with new product producti