

ELECTRONICS FOR IMAGING INC

FORM 10-Q (Quarterly Report)

Filed 11/27/17 for the Period Ending 09/30/17

Address	6750 DUMBARTON CIRCLE FREMONT, CA, 94555
Telephone	6503573500
CIK	0000867374
Symbol	EFII
SIC Code	3576 - Computer Communications Equipment
Industry	Computer Hardware
Sector	Technology
Fiscal Year	12/31

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

or

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: 000-18805

ELECTRONICS FOR IMAGING, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

94-3086355
(I.R.S. Employer
Identification No.)

6750 Dumbarton Circle, Fremont, CA 94555

(Address of principal executive offices) (Zip code)

(650) 357-3500

(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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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). (Check one):

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

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

The number of shares of Common Stock outstanding as of November 17, 2017 was 45,690,919.

Electronics For Imaging, Inc.
INDEX

	<u>Page No.</u>
<u>PART I – Financial Information</u>	
Item 1. <u>Financial Statements</u>	
<u>Condensed Consolidated Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets at September 30, 2017 and December 31, 2016</u>	3
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2017 and 2016</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2017 and 2016</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	34
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	58
Item 4. <u>Controls and Procedures</u>	59
<u>PART II – Other Information</u>	
Item 1. <u>Legal Proceedings</u>	61
Item 1A. <u>Risk Factors</u>	62
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	64
Item 3. <u>Defaults Upon Senior Securities</u>	65
Item 4. <u>Mine Safety Disclosure</u>	65
Item 5. <u>Other Information</u>	65
Item 6. <u>Exhibits</u>	65
<u>Signatures</u>	67
Exhibit 3.1	
Exhibit 3.2	
Exhibit 10.1	
Exhibit 12.1	
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32.1	
Exhibit 101	

PART I – FINANCIAL INFORMATION**Item 1: Condensed Consolidated Financial Statements**

Electronics For Imaging, Inc.
Condensed Consolidated Balance Sheets
(unaudited)

(in thousands)	September 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 175,830	\$ 164,313
Short-term investments, available for sale	217,923	295,428
Accounts receivable, net of allowances of \$32.5 and \$23.3 million, respectively	236,709	220,813
Inventories	131,926	96,338
Income taxes receivable	4,995	975
Assets held for sale	—	3,781
Other current assets	44,865	31,881
Total current assets	812,248	813,529
Property and equipment, net	103,541	103,474
Restricted investments and cash equivalents	27,753	6,252
Goodwill	387,001	359,841
Intangible assets, net	126,567	122,997
Deferred tax assets	61,899	58,477
Other assets	14,827	14,359
Total assets	<u>\$ 1,533,836</u>	<u>\$ 1,478,929</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 133,322	\$ 114,287
Accrued and other liabilities	109,206	85,505
Deferred revenue	58,390	53,813
Income taxes payable	7,635	10,256
Total current liabilities	308,553	263,861
Convertible senior notes, net	315,255	304,484
Imputed financing obligation related to build-to-suit lease	14,087	14,152
Noncurrent contingent and other liabilities	31,067	42,786
Deferred tax liabilities	13,763	15,601
Noncurrent income taxes payable	12,439	12,030
Total liabilities	<u>695,164</u>	<u>652,914</u>
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 5,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.01 par value; 150,000 shares authorized; 54,156 and 53,038 shares issued, respectively	542	530
Additional paid-in capital	741,153	705,901
Treasury stock, at cost; 7,709 and 6,457 shares, respectively	(330,668)	(273,730)
Accumulated other comprehensive loss	(1,243)	(24,575)
Retained earnings	428,888	417,889
Total stockholders' equity	<u>838,672</u>	<u>826,015</u>
Total liabilities and stockholders' equity	<u>\$ 1,533,836</u>	<u>\$ 1,478,929</u>

See accompanying notes to condensed consolidated financial statements.

Electronics For Imaging, Inc.
Condensed Consolidated Statements of Operations
(unaudited)

(in thousands, except per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenue	\$ 248,359	\$ 245,575	\$ 724,097	\$ 725,358
Cost of revenue ⁽¹⁾	120,901	120,381	345,858	356,720
Gross profit	127,458	125,194	378,239	368,638
Operating expenses:				
Research and development ⁽¹⁾	39,585	36,933	118,201	111,731
Sales and marketing ⁽¹⁾	42,269	43,060	129,018	127,360
General and administrative ⁽¹⁾	25,075	24,088	67,239	66,366
Restructuring and other (Note 11)	833	1,308	5,421	5,733
Amortization of identified intangibles	12,299	10,395	34,829	29,360
Total operating expenses	120,061	115,784	354,708	340,550
Income from operations	7,397	9,410	23,531	28,088
Interest expense	(4,912)	(4,510)	(14,538)	(13,243)
Interest income and other income, net	1,760	915	2,802	1,114
Income before income taxes	4,245	5,815	11,795	15,959
Benefit from (provision for) income taxes	(791)	11,847	(795)	9,041
Net income	<u>\$ 3,454</u>	<u>\$ 17,662</u>	<u>\$ 11,000</u>	<u>\$ 25,000</u>
Net income per basic common share	<u>\$ 0.07</u>	<u>\$ 0.38</u>	<u>\$ 0.24</u>	<u>\$ 0.53</u>
Net income per diluted common share	<u>\$ 0.07</u>	<u>\$ 0.37</u>	<u>\$ 0.23</u>	<u>\$ 0.52</u>
Shares used in basic per-share calculation	46,348	46,794	46,442	46,983
Shares used in diluted per-share calculation	46,937	47,621	47,102	47,791

(1) Includes stock-based compensation expense as follows:

	2017	2016	2017	2016
Cost of revenue	\$ 486	\$ 642	\$ 1,985	\$ 1,873
Research and development	1,640	2,061	7,556	6,987
Sales and marketing	1,108	2,260	5,176	6,159
General and administrative	1,414	3,590	7,824	11,923

See accompanying notes to condensed consolidated financial statements.

Electronics For Imaging, Inc.
Condensed Consolidated Statements of Comprehensive Income
(unaudited)

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income	\$3,454	\$17,662	\$11,000	\$25,000
Net unrealized investment gains (losses):				
Unrealized holding gains (losses), net of tax provisions of less than \$0.1 and \$0.2 million for the three and nine months ended September 30, 2017, respectively, and tax benefit of \$0.2 million and tax provision of \$0.5 million for the three and nine months ended September 30, 2016, respectively	48	(316)	283	785
Reclassification adjustments included in net income, net of tax benefit and tax provision of less than \$0.1 million for the three and nine months ended September 30, 2017, and tax benefit and tax provision of less than \$0.1 million for the three and nine months ended September 30, 2016, respectively	(27)	(98)	(49)	16
Net unrealized investment gains (losses)	21	(414)	234	801
Currency translation adjustments, net of no tax benefit for the three and nine months ended September 30, 2017, and tax provisions of \$0.4 and \$0.7 million for the three and nine months ended September 30, 2016, respectively	4,931	1,509	23,121	3,293
Net unrealized gains (losses) on cash flow hedges	(28)	27	(24)	11
Comprehensive income	\$8,378	\$18,784	\$34,331	\$29,105

See accompanying notes to condensed consolidated financial statements.

Electronics For Imaging, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Nine months ended September 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 11,000	\$ 25,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	48,029	40,734
Deferred taxes	(9,149)	(22,127)
Provisions for bad debt and sales-related allowances	10,868	7,558
Provision for inventory obsolescence	3,642	4,492
Stock-based compensation, net of cash settlements	22,541	26,743
Non-cash accretion of interest expense on convertible notes and imputed financing obligation	11,211	9,991
Other non-cash charges and credits	3,254	5,920
Changes in operating assets and liabilities, net of effect of acquired businesses	(58,955)	(42,487)
Net cash provided by operating activities	<u>42,441</u>	<u>55,824</u>
Cash flows from investing activities:		
Purchases of short-term investments	(87,623)	(195,904)
Proceeds from sales and maturities of short-term investments	164,979	223,206
Purchases of restricted investments and cash equivalents	(21,459)	(3,745)
Purchases, net of proceeds from sales, of property and equipment	(8,745)	(17,611)
Businesses purchased, net of cash acquired	(16,739)	(19,614)
Net cash provided by (used for) investing activities	<u>30,413</u>	<u>(13,668)</u>
Cash flows from financing activities:		
Proceeds from issuance of common stock	11,730	10,359
Purchases of treasury stock and net share settlements	(56,937)	(65,354)
Repayment of debt assumed through business acquisitions and debt issuance costs	(10,786)	(8,539)
Contingent consideration payments related to businesses acquired	(9,512)	(1,868)
Net cash used for financing activities	<u>(65,505)</u>	<u>(65,402)</u>
Effect of foreign exchange rate changes on cash and cash equivalents	4,168	2,158
Increase (decrease) in cash and cash equivalents	11,517	(21,088)
Cash and cash equivalents at beginning of period	<u>164,313</u>	<u>164,091</u>
Cash and cash equivalents at end of period	<u><u>\$175,830</u></u>	<u><u>\$ 143,003</u></u>

See accompanying notes to condensed consolidated financial statements.

Electronics For Imaging, Inc.
Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements (“condensed consolidated financial statements”) include the accounts of Electronics For Imaging, Inc. and its subsidiaries (“EFI” or “Company”). All intercompany accounts and transactions have been eliminated in consolidation.

These condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP” or “GAAP”) for interim financial information, rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial statements, and accounting policies consistent in all material respects with those applied in preparing our audited annual consolidated financial statements included in our Annual Report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016. These condensed consolidated financial statements and accompanying notes should be read in conjunction with our annual consolidated financial statements and the notes thereto for the year ended December 31, 2016, included in our Annual Report on Form 10-K, as amended in Amendment No. 2. In the opinion of management, these condensed consolidated financial statements reflect all adjustments, including normal recurring adjustments, management considers necessary for the fair presentation of our financial position, operating results, comprehensive income, and cash flows for the interim periods presented. Our results for the interim periods are not necessarily indicative of results for the entire year.

Correction of Prior Period Financial Information

During the preparation of the consolidated financial statements for three and nine months ended September 30, 2017, we identified certain errors at our Italian manufacturing subsidiary attributable to the valuation and classification of certain finished goods inventory. The errors related to finished goods that should have been impaired and expensed in 2015, inventory utilized in research and development projects that expired and should have been expensed in 2016, and certain assets included in inventory that should have been capitalized and depreciated over their estimated useful lives. The preceding resulted in an understatement of cost of revenue in 2015 and operating expenses in 2016 due to failure to properly impair and expense certain items and properly classify certain amounts included in inventories on the balance sheet and appropriately depreciate those amounts.

As a result, we have corrected the accompanying condensed consolidated balance sheet as of December 31, 2016 as follows:

(in thousands)	December 31, 2016		
	As Previously Reported	Adjustments	As Adjusted
Inventories	\$ 99,075	\$ (2,737)	\$ 96,338
Property and equipment, net	103,304	170	103,474
Total assets	1,481,496	(2,567)	1,478,929
Deferred tax liabilities	16,351	(750)	15,601
Total liabilities	653,664	(750)	652,914
Accumulated other comprehensive loss	(24,694)	119	(24,575)
Retained earnings	419,825	(1,936)	417,889
Total shareholders' equity	827,832	(1,817)	826,015

We consider this correction to previously issued financial statements to be immaterial.

The impact to net income for the years ended December 31, 2016 and 2015 for this correction is a decrease of \$0.6 and \$1.3 million, respectively, from amounts previously reported of \$45.5 and \$33.5 million, respectively.

Significant Accounting Policies

There have been no material changes in our significant accounting policies, as compared to the significant accounting policies described in our Annual Report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016, with the exception of the following:

[Table of Contents](#)

Bill and Hold Transactions. We hold certain products manufactured by us on a “bill-and-hold” basis for our customers’ convenience. Revenue is recognized for these “bill-and-hold” arrangements in accordance with SEC Staff Accounting Bulletin (“SAB”) 104, which requires consideration of, among other things, whether the customer has made a fixed commitment to purchase the product; the existence of a substantial business purpose for the arrangement; the “bill-and-hold” arrangement is at the request of the customer; the scheduled delivery date must be reasonable and consistent with the buyer’s business purpose; title and risk of ownership must pass to the customer, including any decline in the market value of the product; the product is complete and ready for shipment; the product has been segregated from our inventory; payment terms for such arrangements have not been modified from our normal billing and credit terms; our custodial risks must be insurable and insured; and no further performance obligations by us exist. Extended procedures are not necessary to assure that there are no exceptions to the customer’s commitment to accept and pay for the product.

Out-of-Period Adjustments

In the nine months ended September 30, 2017, we recorded out-of-period adjustments related to certain bill and hold transactions, which decreased revenue by \$3.4 million, decreased gross profit by \$0.5 million, and decreased net income by \$0.3 million (or \$0.01 per diluted share). There were no such out-of-period adjustments in the three months ended September 30, 2017. We evaluated these adjustments considering both qualitative and quantitative factors and the impact of these adjustments in relation to each period, as well as the periods in which they originated. The impact of recognizing these adjustments in prior years was not material to any individual period. Management believes these adjustments are immaterial to these condensed consolidated financial statements and all previously issued financial statements. Such out-of-period adjustments are not part of the Correction of Prior Period Financial Information described above.

Recent Accounting Pronouncements

Inventory Valuation. In July 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-11, Simplifying the Measurement of Inventory, which became effective in the first quarter of 2017. ASU 2015-11 requires that inventory be valued at the lower of cost or net realizable value, which is defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. We previously valued inventory at the lower of cost or net realizable value less a reasonable profit margin as allowed by previous inventory valuation guidance. The adoption of ASU 2015-11 increased our inventory valuation by \$1.7 million as of September 30, 2017.

Revenue Recognition. ASU 2014-09, Revenue from Contracts with Customers, issued in May 2014, ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, and subsequent amendments, enhance the comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. The principles-based guidance provides a framework for addressing revenue recognition issues comprehensively. The standards require that revenue be recognized that reflects the consideration the entity expects to be entitled in exchange for goods or services, which are referred to as performance obligations.

[Table of Contents](#)

ASU 2014-09 will be effective in the first quarter of 2018. Two adoption methods are allowed under ASU 2014-09: the full retrospective method and modified retrospective method. We have elected to use the modified retrospective method by applying the revised guidance to contracts that have not been completed as of January 1, 2018. Retained earnings will be adjusted for the cumulative effect of the change on January 1, 2018. The new standard requires comprehensive annual and interim disclosures regarding the nature, amount, timing, and uncertainty of recognized revenue, which will be provided in the year of adoption along with the impact on recognized revenue compared with revenue that would have been recognized under prior guidance. Qualitative and quantitative disclosures will be required regarding:

- disaggregation of our current disclosures of revenue by segment and geographic area into categories that depict how revenue and cash flows are impacted by economic factors,
- timing of recognition, contract duration, and sales channel,
- billed and unbilled contracts with customers, including revenue and impairments recognized, disaggregation, and information about contract balances and performance obligations,
- significant judgments and changes in judgments required to determine the transaction price, amounts allocated to performance obligations, and the timing for recognizing revenue resulting from the satisfaction of performance obligations,
- assets recognized from the costs to obtain or fulfill a contract (e.g., commissions), and
- bad debt provisions related to billed and unbilled receivables.

Upon evaluation, we believe the key changes in the guidance that impact our revenue recognition relate to the timing of revenue recognition and allocation of contract revenue between services and software licenses. The requirement to defer incremental contract acquisition costs (e.g., commissions) and recognize them over the contract period or expected customer life will result in the recognition of a deferred charge on our balance sheet. We are assessing the impact on our consolidated financial statements, systems, and controls upon adoption.

Principal vs Agent. ASU 2016-08, Principal vs. Agent Considerations (Reporting Revenue Gross vs Net), issued in March 2016, streamlines and clarifies the criteria for identifying whether an entity is satisfying a performance obligation as the principal or agent in the transaction. The entity that is responsible for fulfilling the contractual obligations related to the good or service is acting as the principal and recognizes the gross amount of consideration. The entity that is responsible only for arranging delivery to the customer is acting as the agent and recognizes revenue in the amount of the fee or commission related to arranging for the delivery of the good or service.

Several indicators of the nature of the relationship that are considered under current guidance have been streamlined and clarified in the new guidance by focusing more specifically on the performance obligations that must be fulfilled in the transaction, which entity carries the inventory risk in the transaction, and which entity controls the pricing of the good or service. Credit risk will no longer be a criterion. This guidance will be effective in the first quarter of 2018. We are evaluating its impact on our revenue and results of operations related to third party ink revenue and certain printer components.

Financial Instruments. ASU 2016-13, Measurement of Credit Losses on Financial Instruments, issued in June 2016, amends current guidance regarding other-than-temporary impairment of available-for-sale debt securities. The new guidance requires an estimate of expected credit loss when fair value is below the amortized cost of the asset without regard for the length of time that the fair value has been below the amortized cost or the historical or implied volatility of the asset. Credit losses on available-for-sale debt securities will be limited to the difference between the security's amortized cost basis and its fair value. The use of an allowance to record estimated credit losses (and subsequent recoveries) will also be required under the new guidance.

ASU 2016-13 will be effective in the first quarter of 2020. We are evaluating its impact on the carrying value of our available-for-sale securities and results of operations.

Settlement of Convertible Debt. ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments, issued in August 2016, requires that cash settlements of principal amounts of debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the debt must classify the portion of the principal payment attributable to the accreted interest related to the debt discount as cash outflows from operating activities. This is consistent with the classification of the coupon interest payments.

[Table of Contents](#)

ASU 2016-15 will be effective in the first quarter of 2018. Accordingly, \$63.6 million debt discount attributable to the difference between the 0.75% coupon interest rate on our 0.75% Convertible Senior Notes Due 2019 (“Notes”) and the 4.98% (5.46% inclusive of debt issuance costs) effective interest rate will be classified as an operating cash outflow in the Condensed Consolidated Statement of Cash Flows upon cash settlement. If we settle the conversion of the Notes in cash on or prior to the maturity date of September 1, 2019, the cash outflow of \$63.6 million will be recorded in operating activities in the Consolidated Statement of Cash Flows.

Restricted Cash. In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows: Restricted Cash, requiring that the statement of cash flows explain the change in cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. Under current guidance, changes in restricted cash and restricted cash equivalents are included in operating or investing activities in the Condensed Consolidated Statements of Cash Flows.

ASU 2016-18 will be effective in the first quarter of 2018. Changes in restricted cash related to the off-balance sheet financing arrangement described in Note 8 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements will no longer be presented as an investing cash outflow, but will instead be presented as a component of the beginning and ending balance of cash, cash equivalents, and restricted cash in the Condensed Consolidated Statements of Cash Flows.

Lease Arrangements. Under current guidance, the classification of a lease by a lessee as either an operating or capital lease determines whether an asset and liability is recognized on the balance sheet. ASU 2016-02, Leases, issued in February 2016 and effective in the first quarter of 2019, requires that a lessee recognize an asset and liability on its balance sheet related to all leases with terms in excess of one year. For all leases, a lessee will be required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. The right-to-use asset represents the right to use the underlying asset during the lease term.

The recognition, measurement, and presentation of expenses and cash flows by a lessee have not significantly changed from previous guidance. There continues to be a differentiation between finance leases and operating leases. The criteria for determining whether a lease is a financing or operating lease are substantially the same as existing guidance except that the “bright line” percentages have been removed.

- For finance leases, interest is recognized on the lease liability separately from depreciation of the right-of-use asset in the statement of operations. Principal repayments are classified within financing activities and interest payments are classified as operating activities in the statement of cash flows.
- For operating leases, a lessee is required to recognize lease expense generally on a straight-line basis. All operating lease payments are classified as operating activities in the statement of cash flows.

The current build-to-suit lease accounting guidance will be rescinded by the new guidance, although simplified guidance will remain regarding lessee control during the construction period. Consequently, the accounting for build-to-suit leases will be the same as finance leases unless the lessee control provisions are applicable.

We have not quantified the impact, but the requirement to recognize a right-of-use asset and a lease liability related to operating leases will have a material impact on our consolidated financial position as reflected in our Consolidated Balance Sheets. As stated above, the recognition, measurement, and presentation of expenses and cash flows by a lessee have not significantly changed from previous guidance; accordingly, the impact on our results of operations as reflected in our Consolidated Statements of Operations is not expected to be material.

Definition of a Business. ASU 2017-01, Business Combinations: Clarifying the Definition of a Business, was issued in January 2017, and significantly narrows how businesses are defined. Under current guidance, a business is defined as an integrated set of assets and activities that usually consists of business processes and their related inputs and outputs. However, business process outputs are not required to be present and only some business process inputs and business processes must be present if the acquiring entity can produce outputs by integrating the acquired set of assets and activities with its own inputs and processes. Essentially, existing guidance only requires that business processes and inputs be present in order to constitute a business.

[Table of Contents](#)

Under ASU 2017-01, when substantially all of the fair value of the gross assets acquired is concentrated in a single asset or group of similar identifiable assets, then the assets acquired do not constitute a business. If substantially all of the fair value of the gross assets acquired is not concentrated in a single asset or group of similar assets, then the assets acquired may constitute a business if certain criteria are met. We must determine whether the acquired gross assets and activities include an input and a “substantive” process that together “significantly” contribute to the ability to create an output. A framework and specific criteria are provided to assist with the evaluation of whether a process is “substantive” and “significantly contributes” to the ability to create an output. “Output” is narrowly defined to be consistent with the description of a performance obligation in the new revenue guidance. Missing inputs and processes may not be replaced by integration with our own inputs and processes under the new guidance.

Our condensed consolidated financial statements may be impacted if an acquisition does not qualify as a business combination after ASU 2017-01 is effective in the first quarter of 2018. Such acquisitions would be accounted for as asset purchases.

Nonfinancial Asset Derecognition. In February 2017, the FASB issued ASU 2017-05, Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets: Clarifying the Scope of Asset Derecognition and Accounting for Partial Sales of Nonfinancial Assets, which clarifies the scope of recent guidance as it relates to nonfinancial asset derecognition and the accounting for partial sales of nonfinancial assets. The ASU conforms the derecognition guidance as it relates to nonfinancial assets with the derecognition guidance in the new revenue standard (ASU 2014-09) and is expected to have a material impact on the accounting for real estate dispositions.

ASU 2017-05 will be effective in the first quarter of 2018. We have elected to adopt the modified retrospective method of implementation.

Stock Compensation Modification. In May 2017, the FASB issued ASU 2017-09, Stock Compensation – Scope of Modification Accounting, which clarifies the scope of modification accounting for share-based payment arrangements. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification.

ASU 2017-09 will be effective in the first quarter of 2018. We will adopt this guidance prospectively to awards modified on or after the adoption date. We do not believe this guidance will materially impact our results of operations.

Hedge Accounting. In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities, which amends the hedge accounting recognition and presentation requirements in Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging.

Our foreign currency derivative contracts include notional amounts of \$3.8 million that have been designated as cash flow hedges of our Indian rupee operating expense exposure at September 30, 2017. Under current guidance, changes in the fair value of the effective portion of these contracts are reported as a component of other comprehensive income (“OCI”) and reclassified to operating expense in the periods of payment of the hedged cash flows. The ineffective portion is recognized as a component of interest income and other income, net. Under the new guidance, the entire change in the fair value of hedging instruments designated as cash flow hedges that are included in the assessment of hedge effectiveness will be recorded in OCI. Those amounts are reclassified to earnings in the periods of payment in the same income statement line item as the hedged operating expenses. Upon adoption, a cumulative-effect adjustment will be required to charge the ineffective portion of derivative contracts designated as cash flow hedges existing at the date of adoption to accumulated OCI with a corresponding adjustment to the retained earnings as of the beginning of the fiscal year of the adoption.

The new guidance continues to require an initial prospective quantitative hedge effectiveness assessment unless the hedging relationship qualifies for the critical-terms-match method or facts and circumstances method, which permit an assumption of perfect hedge effectiveness. After the initial quantitative assessment, the new guidance permits a qualitative ongoing effectiveness assessment for certain hedges if we can reasonably support an expectation of high effectiveness throughout the term of the hedge. The new guidance also requires additional disclosure related to the effect on the income statement of cash flow hedges.

ASU 2017-12 will be effective in the first quarter of 2019. We do not believe this guidance will materially impact our results of operations.

Supplemental Cash Flow Information

<u>(in thousands)</u>	Nine months ended September 30,	
	2017	2016
Net cash paid for income taxes	\$ 15,724	\$ 5,787
Cash paid for interest expense	\$ 3,667	\$ 3,285
Acquisition of businesses		
Cash paid for businesses purchased, excluding contingent consideration	\$ 16,836	\$ 21,242
Cash acquired in business acquisitions	(97)	(1,628)
Net cash paid for businesses purchased, net of cash acquired	\$ 16,739	\$ 19,614
Common stock issued in connection with Reggiani Macchine SpA (“Reggiani”) acquisition	\$ —	\$ 73
Non-cash investing and financing activities:		
Non-cash settlement of vacation liabilities by issuing restricted stock units (“RSUs”)	\$ —	\$ 2,758
Property and equipment received, but not paid	703	1,004
	<u>\$ 703</u>	<u>\$ 3,762</u>

2. Earnings Per Share

Net income per basic common share is computed using the weighted average number of common shares outstanding during the period. Net income per diluted common share is computed using the weighted average number of common and dilutive potential common shares outstanding during the period. Potential common shares result from the assumed exercise of outstanding common stock options having a dilutive effect using the treasury stock method, non-vested shares of restricted stock having a dilutive effect, non-vested restricted stock for which the performance criteria have been met, shares to be purchased under our Employee Stock Purchase Plan (“ESPP”) having a dilutive effect, the assumed release of shares from escrow related to the acquisition of Corrugated Technologies, Inc. (“CTI”), the assumed conversion of our Notes having a dilutive effect using the treasury stock method when the stock price exceeds the conversion price of the Notes, and the assumed exercise of our warrants having a dilutive effect using the treasury stock method when the stock price exceeds the warrant strike price. Any potential shares that are anti-dilutive as defined in ASC 260, Earnings Per Share, are excluded from the effect of dilutive securities.

Performance-based and market-based restricted stock and stock options that would be issuable if the end of the reporting period were the end of the vesting period, if the result would be dilutive, are assumed to be outstanding for purposes of determining net income per diluted common share as of the later of the beginning of the period or the grant date in accordance with ASC 260-10-45-48. Accordingly, performance-based RSUs, which vested on various dates during the three and nine months ended September 30, 2017 and 2016, based on achievement of specified performance criteria related to revenue, cash flows from operating activities, and non-GAAP operating income targets, and performance-based stock options, which vested during the nine months ended September 30, 2016 based on achievement of specified targets related to non-GAAP return on equity, are included in the determination of net income per diluted common share as of the beginning of each period.

Basic and diluted earnings per share during the three and nine months ended September 30, 2017 and 2016 are reconciled as follows (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Basic net income per share:				
Net income available to common shareholders	\$ 3,454	\$ 17,662	\$ 11,000	\$ 25,000
Weighted average common shares outstanding	46,348	46,794	46,442	46,983
Basic net income per share	<u>\$ 0.07</u>	<u>\$ 0.38</u>	<u>\$ 0.24</u>	<u>\$ 0.53</u>

[Table of Contents](#)

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Dilutive net income per share:				
Net income available to common shareholders	\$ 3,454	\$ 17,662	\$ 11,000	\$ 25,000
Weighted average common shares outstanding	46,348	46,794	46,442	46,983
Dilutive stock options and non-vested restricted stock	589	827	660	808
Weighted average common shares outstanding for purposes of computing diluted net income per share	46,937	47,621	47,102	47,791
Dilutive net income per share	\$ 0.07	\$ 0.37	\$ 0.23	\$ 0.52

Potential shares of common stock that were not included in the determination of diluted net income per share for the periods presented because the impact of including them would have been anti-dilutive or performance conditions have not been met, consisted of the following (in thousands):

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
RSUs	327	669	304	601
ESPP purchase rights	410	14	342	29
Total potential shares of common stock excluded from the computation of diluted earnings per share	737	683	646	630

The weighted-average number of common shares outstanding does not include the effect of the potential common shares from conversion of our Notes and exercise of our Warrants. The effects of these potentially outstanding shares were not included in the calculation of diluted net income per share because the effect would have been anti-dilutive since the conversion price of the Notes and the strike price of the Warrants exceeded the average market price of our common stock. We have the option to pay cash, issue shares of common stock, or any combination thereof for the aggregate amount due upon conversion of the Notes. Our intent is to settle the principal amount of the Notes in cash upon conversion. As a result, only amounts payable in excess of the principal amount of the Notes are considered in diluted net income per share under the treasury stock method. The Note Hedges are not included in the calculation of diluted net income per share because the effect of any exercise of the Note Hedges would be anti-dilutive. Please refer to Note 6 – Convertible Senior Notes, Note Hedges, and Warrants of the Notes to Condensed Consolidated Financial Statements for additional information.

3. Balance Sheet Details

Inventories

Inventories, net of allowances, as of September 30, 2017, and December 31, 2016, are as follows (in thousands):

	<u>September 30,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Raw materials	\$ 57,059	\$ 45,798
Work in process	14,676	7,362
Finished goods	60,191	43,178
	<u>\$ 131,926</u>	<u>\$ 96,338</u>

Deferred Cost of Revenue

Deferred cost of revenue related to unrecognized revenue on shipments to customers was \$7.2 and \$3.4 million as of September 30, 2017, and December 31, 2016, respectively, and is included in other current assets in our Condensed Consolidated Balance Sheets.

[Table of Contents](#)*Product Warranty Reserves*

Product warranty reserves are included in accrued and other liabilities on our Condensed Consolidated Balance Sheets. The changes in product warranty reserves during the nine months ended September 30, 2017 and 2016 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Balance at January 1,	\$ 10,319	\$ 9,635
Liability assumed upon acquiring FreeFlow print server (“FFPS”)	9,368	—
Provisions, net of releases	9,284	9,678
Settlements	(12,588)	(9,156)
Balance at September 30,	<u>\$ 16,383</u>	<u>\$10,157</u>

Accumulated Other Comprehensive Loss (“OCI”)

OCI classified within stockholders’ equity in our Condensed Consolidated Balance Sheets as of September 30, 2017, and December 31, 2016 is as follows (in thousands):

	<u>September 30, 2017</u>	<u>December 31, 2016</u>
Net unrealized investment losses	\$ (239)	\$ (473)
Currency translation losses	(989)	(24,111)
Net unrealized gain (loss) on cash flow hedges	(15)	9
Accumulated other comprehensive loss	<u>\$ (1,243)</u>	<u>\$ (24,575)</u>

Amounts reclassified out of OCI were less than \$0.1 million, net of tax, for the three and nine months ended September 30, 2017, \$0.1 million, net of tax, for the three months ended September 30, 2016, and less than \$0.1 million, net of tax, for the nine months ended September 30, 2016, and consisted of unrealized gains and losses from investments in debt securities that are reported within interest income and other income, net, in our Condensed Consolidated Statements of Operations.

4. Acquisitions

We acquired privately held Generation Digital Solutions, Inc. (“GD”), CRC Information Systems, Inc. (“CRC”) from Reynolds and Reynolds Company (“Reynolds”), and certain assets comprising the FFPS business from Xerox Corporation (“Xerox”), during 2017, which have been included in our Fieri or Productivity Software operating segments. Acquisition-related transaction costs were \$0.6 and \$1.8 million during the three and nine months ended September 30, 2017, respectively, and \$0.4 and \$1.7 million during the three and nine months ended September 30, 2016, respectively, related to all acquisitions.

These acquisitions were accounted for as purchase business combinations. We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair value on their acquisition dates. Excess purchase consideration was recorded as goodwill. Factors contributing to a purchase price that results in goodwill include, but are not limited to, the retention of research and development personnel with skills to develop future technology, support personnel to provide maintenance services related to the products, a trained sales force capable of selling current and future products, the opportunity to cross-sell products of the acquired businesses to existing customers, the opportunity to integrate acquired technology into our products, the positive reputation of GD, CRC, and FFPS in the market, integration of the GD digital textile design workflow with our Fieri textile digital front ends (“DFEs”) and Reggiani digital textile printers linking textile design and production, the opportunity to sell Fieri DFEs to FFPS customers, and the opportunity to expand our presence in the DFE market through the synergy of FFPS technology with existing Fieri products.

We engaged a third party valuation firm to aid management in its analyses of the fair value of these acquired businesses. All estimates, key assumptions, and forecasts were either provided by or reviewed by us. While we chose to utilize a third party valuation firm, the fair value analyses and related valuations represent the conclusions of management and not the conclusions or statements of any third party.

The purchase price allocations are preliminary and subject to change within the measurement period as the valuations are finalized. We expect to continue to obtain information to assist us in finalizing the fair value of the net assets acquired during the measurement period, which end at various dates in 2018. Measurement period adjustments will be recognized in the reporting period in which the adjustment amounts are determined, if any.

[Table of Contents](#)

Fiery Operating Segment

We acquired privately held GD, which is a New York corporation headquartered in New York City on August 14, 2017 for cash consideration of \$3.2 million, net of cash acquired, plus an additional potential future cash earnout, which is contingent on achieving certain revenue and operating profit performance targets during a six-month period followed sequentially by a 12-month period. GD provides software to textile and fashion designers for the creation and design of prints and patterns, color matching, and color palette creation and management. GD will be integrated into the Fiery operating segment.

The fair value of the earnout related to the GD acquisition is currently estimated to be \$3.6 million at September 30, 2017, by applying the income approach in accordance with ASC 805-30-25-5, Business Combinations. Key assumptions include risk-free discount rate of 2.83% and probability-adjusted revenue and operating profit levels. Probability-adjusted revenue and operating profit are significant inputs that are not observable in the market, which ASC 820-10-35 refers to as a Level 3 inputs. This contingent liability is reflected in our Consolidated Balance Sheet as of September 30, 2017, as a current and noncurrent liability of \$1.0 and \$2.6 million, respectively, with the first payment due in the third quarter of 2018, if earned. In accordance with ASC 805-30-35-1, changes in the fair value of contingent consideration subsequent to the acquisition date are recognized in general and administrative expenses.

We acquired certain assets comprising the FFPS business from Xerox, a New York corporation headquartered in Norwalk, Connecticut, on January 31, 2017. The FFPS business manufactures and markets the FFPS DFE, which is a DFE that previously competed with our Fiery DFEs and is included in our Fiery operating segment.

We purchased FFPS for cash consideration of \$23.9 million consisting of \$5.9 million paid at closing, \$9.0 million paid in July 2017, and \$9.0 million payable in July 2018, which have been discounted at our incremental borrowing rate of 4.98%, resulting in a purchase price of \$23.1 million.

Productivity Software Operating Segment

We acquired privately held CRC, which is a Michigan corporation headquartered in Scottsdale, Arizona, from Reynolds, which is an Ohio corporation headquartered in Dayton, Ohio, on May 8, 2017, for cash consideration of \$7.6 million. CRC provides business process automation software for label and packaging printers for commercial businesses and is included in the Midmarket Print Suite within our Productivity Software operating segment.

Valuation Methodologies

Intangible assets acquired consist of customer relationships, the Master Purchasing Agreement (the “Purchasing Agreement”) with Xerox, “take-or-pay” contractual penalty, trade names, existing technologies, and in-process research & development (“IPR&D”). The intangible asset valuation methodologies for each acquisition assume a risk-free discount rate of 4.98% or probability-adjusted discount rates between 13% and 23%.

Customer Relationships and Backlog were valued using the excess earnings method, which is an income approach. The value of customer relationships lies in the generation of a consistent and predictable revenue source and the avoidance of costs associated with developing the relationships. Customer relationships were valued by estimating the revenue attributable to existing customer relationships and probability-weighting each forecast year to reflect the uncertainty of maintaining existing relationships based on historical attrition rates.

Trade Names were valued using the relief from royalty method, which is an income approach, with royalty rates based on various factors including an analysis of market data, comparable trade name agreements, and historical advertising dollars spent supporting the trade name.

Existing Technologies were valued using the relief from royalty method based on royalty rates for similar technologies. The values of existing technologies are derived from consistent and predictable revenue, including the opportunity to cross-sell to existing customers, and the avoidance of the costs associated with developing the technologies. Revenue related to existing technologies was adjusted in each forecast year to reflect the evolution of the technology and the cost of sustaining research and development required to maintain the technology.

[Table of Contents](#)

Purchasing Agreement was valued using the excess earnings method, which is an income approach. The Purchasing Agreement entered into with Xerox states that we will be Xerox's preferred supplier of DFEs provided that we meet quality, cost, delivery, and services requirements. The value of the Purchasing Agreement lies in the generation of a consistent and predictable revenue source without incurring the costs normally required to acquire the Purchasing Agreement. The Purchasing Agreement was valued by estimating the revenue attributable to the Purchasing Agreement and probability-weighting each forecast year to reflect the uncertainty of maintaining the existing relationship with Xerox beyond the initial five-year term of the agreement.

Take-or-pay Contract was valued using the Monte Carlo method, which is an income approach. If Xerox's purchases of Fiery and FFPS DFEs during each of four consecutive 12-month periods is less than the minimum level defined for each purchase period, then Xerox shall make a one-time payment in an amount equal to a percentage of such shortfall compared to the minimum level, subject to the maximum payment amount agreed between the parties for each purchase period. Key assumptions include a risk-free discount rate of 4.98%, asset volatility of 27%, and probability-adjusted DFE revenue. If Xerox's purchases of Fiery and FFPS DFEs exceed the minimum purchase levels defined for each purchase period, then we will pay a percentage of such excess to Xerox.

IPR&D was valued using the relief from royalty method by estimating the cost to develop purchased IPR&D into commercially viable products, estimating the net cash flows resulting from the sale of those products, and discounting the net cash flows back to their present value. FFPS project schedules were 63% complete as of the acquisition date and have been completed as of September 30, 2017, based on management's estimate that technical and commercial feasibility has been achieved. IPR&D is subject to amortization after product completion over the product life or otherwise assessed for impairment in accordance with acquisition accounting guidance. Additional costs incurred to complete IPR&D after the acquisition were expensed.

The preliminary allocation of the purchase price to the assets acquired and liabilities assumed (in thousands) with respect to these acquisitions at their respective acquisition dates is summarized as follows:

	Fiery				Productivity Software	
	FFPS		GD		CRC	
	Weighted average useful life	Purchase Price Allocation	Weighted average useful life	Purchase Price Allocation	Weighted average useful life	Purchase Price Allocation
Purchasing agreement	10 years	\$ 9,330	—	\$ —	—	\$ —
Take-or-pay contract	4 years	9,000	—	—	—	—
Customer relationships	—	—	8 years	3,030	9 years	3,580
Existing technology	2 years	2,570	5 years	890	4 years	540
Trade names	5 years	1,020	5 years	290	4 years	180
IPR&D	less than one year	70	—	—	—	—
Backlog	—	—	—	—	less than one year	4
Goodwill	—	6,236	—	3,012	—	4,595
		<u>28,226</u>		<u>\$ 7,222</u>		<u>\$ 8,899</u>
Net tangible assets (liabilities)		(5,092)		(298)		(1,299)
Total purchase price		<u>\$ 23,134</u>		<u>\$ 6,924</u>		<u>\$ 7,600</u>

Pro forma results of operations have not been presented because they are not material to our Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2017 and 2016. Goodwill, which represents the excess of the purchase price over the net tangible and intangible assets acquired, that was generated by our acquisition of CRC is not deductible for tax purposes. Goodwill that was generated by our acquisitions of GD and FFPS is deductible for tax purposes.

5. Investments and Fair Value Measurements

We invest our excess cash on deposit with major banks in money market, U.S. Treasury and government-sponsored entity, corporate, municipal government, asset-backed, and mortgage-backed residential debt securities. By policy, we invest primarily in high-grade marketable securities. We are exposed to credit risk in the event of default by the financial institutions or issuers of these investments to the extent of amounts recorded in our Condensed Consolidated Balance Sheets.

We consider all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents. Typically, the cost of these investments has approximated fair value. Marketable investments with a maturity greater than three months are classified as available-for-sale short-term investments. Available-for-sale securities are stated at fair value with unrealized gains and losses reported as a separate component of OCI, adjusted for deferred income taxes. The credit portion of any other-than-temporary impairment is included in net income. Realized gains and losses on sales of financial instruments are recognized upon sale of the investments using the specific identification method.

[Table of Contents](#)

Our available-for-sale short-term investments as of September 30, 2017, and December 31, 2016, are as follows (in thousands):

	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
September 30, 2017				
U.S. Government and sponsored entities	\$ 65,345	\$ 2	\$ (358)	\$ 64,989
Corporate debt securities	138,399	152	(200)	138,351
Municipal government	1,047	—	(1)	1,046
Asset-backed securities	12,823	47	(21)	12,849
Mortgage-backed securities – residential	689	1	(2)	688
Total short-term investments	<u>\$ 218,303</u>	<u>\$ 202</u>	<u>\$ (582)</u>	<u>\$ 217,923</u>
December 31, 2016				
U.S. Government and sponsored entities	\$ 70,893	\$ 49	\$ (348)	\$ 70,594
Corporate debt securities	198,166	102	(621)	197,647
Municipal government	1,278	—	(1)	1,277
Asset-backed securities	24,233	79	(17)	24,295
Mortgage-backed securities – residential	1,615	3	(3)	1,615
Total short-term investments	<u>\$ 296,185</u>	<u>\$ 233</u>	<u>\$ (990)</u>	<u>\$ 295,428</u>

The fair value and duration that investments, including cash equivalents, have been in a gross unrealized loss position as of September 30, 2017, and December 31, 2016 are as follows (in thousands):

	<u>Less than 12 Months</u>		<u>More than 12 Months</u>		<u>TOTAL</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
September 30, 2017						
U.S. Government and sponsored entities	\$ 45,777	\$ (158)	\$ 18,040	\$ (199)	\$ 63,817	\$ (357)
Corporate debt securities	57,158	(138)	21,315	(63)	78,473	(201)
Municipal government	379	(1)	—	—	379	(1)
Asset-backed securities	11,959	(20)	805	(1)	12,764	(21)
Mortgage-backed securities – residential	351	(2)	11	—	362	(2)
Total	<u>\$ 115,624</u>	<u>\$ (319)</u>	<u>\$ 40,171</u>	<u>\$ (263)</u>	<u>\$ 155,795</u>	<u>\$ (582)</u>
December 31, 2016						
U.S. Government and sponsored entities	\$ 39,810	\$ (348)	\$ —	\$ —	\$ 39,810	\$ (348)
Corporate debt securities	133,382	(581)	13,158	(40)	146,540	(621)
Municipal government	1,268	(1)	—	—	1,268	(1)
Asset-backed securities	4,540	(7)	4,611	(10)	9,151	(17)
Mortgage-backed securities – residential	428	(1)	153	(2)	581	(3)
Total	<u>\$ 179,428</u>	<u>\$ (938)</u>	<u>\$ 17,922</u>	<u>\$ (52)</u>	<u>\$ 197,350</u>	<u>\$ (990)</u>

For fixed income securities that have unrealized losses as of September 30, 2017, we have determined that we do not have the intent to sell any of these investments and it is not more likely than not that we will be required to sell any of these investments before recovery of the entire amortized cost basis. We have evaluated these fixed income securities and determined that no credit losses exist. Accordingly, management has determined that the unrealized losses on our fixed income securities as of September 30, 2017, were temporary in nature.

Amortized cost and estimated fair value of investments as of September 30, 2017, are summarized by maturity date as follows (in thousands):

	<u>Amortized cost</u>	<u>Fair value</u>
Mature in less than one year	\$ 56,677	\$ 56,646
Mature in one to three years	161,626	161,277
Total short-term investments	<u>\$ 218,303</u>	<u>\$ 217,923</u>

[Table of Contents](#)

Net realized gains of less than \$0.1 and \$0.2 million from sales of investments were recognized in interest income and other income, net, during the three and nine months ended September 30, 2017, respectively. Net realized gains of \$0.1 and \$0.3 million from sales of investments were recognized in interest income and other income, net, during the three and nine months ended September 30, 2016, respectively. Net unrealized losses of \$0.4 and \$0.8 million were included in OCI in the accompanying Condensed Consolidated Balance Sheets as of September 30, 2017, and December 31, 2016, respectively.

Fair Value Measurements

ASC 820, Fair Value Measurements, identifies fair value as the exchange price, or exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a three-tier fair value hierarchy as follows:

Level 1: Inputs that are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date;

Level 2: Inputs that are other than quoted prices included within Level 1, that are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date for the duration of the instrument's anticipated life or by comparison to similar instruments; and

Level 3: Inputs that are unobservable or reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. These include management's own judgments about market participant assumptions developed based on the best information available in the circumstances.

We utilize the market approach to measure the fair value of our fixed income securities. The market approach is a valuation technique that uses the prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The fair value of our fixed income securities is obtained using readily-available market prices from a variety of industry standard data providers, large financial institutions, and other third-party sources for the identical underlying securities. The fair value of our investments in certain money market funds is expected to maintain a Net Asset Value of \$1 per share and, as such, is priced at the expected market price.

We obtain the fair value of our Level 2 financial instruments from several third party asset managers, custodian banks, and the accounting service providers. Independently, these service providers use professional pricing services to gather pricing data, which may include quoted market prices for identical or comparable instruments or inputs other than quoted prices that are observable either directly or indirectly. As part of this process, we engaged a pricing service to assist management in its pricing analysis and assessment of other-than-temporary impairment. All estimates, key assumptions, and forecasts were either provided by or reviewed by us. While we chose to utilize a third party pricing service, the impairment analysis and related valuations represent conclusions of management and not conclusions or statements of any third party.

Our investments and liabilities measured at fair value have been presented in accordance with the fair value hierarchy specified in ASC 820 as of September 30, 2017, and December 31, 2016 in order of liquidity as follows (in thousands):

	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant other Observable Inputs (Level 2)</u>	<u>Unobservable Inputs (Level 3)</u>
September 30, 2017				
Assets:				
Money market funds	\$ 24,426	\$ 24,426	\$ —	\$ —
U.S. Government and sponsored entities	64,989	38,966	26,023	—
Corporate debt securities	138,351	—	138,351	—
Municipal government	1,046	—	1,046	—
Asset-backed securities	12,849	—	12,795	54
Mortgage-backed securities – residential	687	—	687	—
	<u>\$242,348</u>	<u>\$ 63,392</u>	<u>\$178,902</u>	<u>\$ 54</u>
Liabilities:				
Contingent consideration, current and noncurrent	\$ 53,520	\$ —	\$ —	\$ 53,520
Self-insurance	935	—	—	935
	<u>\$ 54,455</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 54,455</u>

	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant other Observable Inputs (Level 2)</u>	<u>Unobservable Inputs (Level 3)</u>
December 31, 2016				
Assets:				
Money market funds	\$ 23,575	\$ 23,575	\$ —	\$ —
U.S. Government and sponsored entities	70,594	51,870	18,724	—
Corporate debt securities	197,647	—	197,647	—
Municipal government	1,277	—	1,277	—
Asset-backed securities	24,295	—	24,228	67
Mortgage-backed securities – residential	1,615	—	1,615	—
	<u>\$ 319,003</u>	<u>\$ 75,445</u>	<u>\$ 243,491</u>	<u>\$ 67</u>
Liabilities:				
Contingent consideration, current and noncurrent	\$ 56,463	\$ —	\$ —	\$ 56,463
Self-insurance	1,542	—	—	1,542
	<u>\$ 58,005</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 58,005</u>

Money market funds consist of \$24.4 and \$23.6 million, which have been classified as cash equivalents as of September 30, 2017, and December 31, 2016, respectively.

Investments are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices or alternative pricing sources with reasonable levels of price transparency. Investments in U.S. Treasury obligations and overnight money market mutual funds have been classified as Level 1 because these securities are valued based on quoted prices in active markets or are actively traded at \$1.00 Net Asset Value. There have been no transfers between Level 1 and 2 during the nine months ended September 30, 2017 and 2016.

Government agency investments and corporate debt instruments, including investments in asset-backed and mortgage-backed securities, have generally been classified as Level 2 because markets for these securities are less active or valuations for such securities utilize significant inputs, which are directly or indirectly observable. We hold asset-backed securities with income payments derived from and collateralized by a specified pool of underlying assets. Asset-backed securities in the portfolio are predominantly collateralized by credit cards and auto loans. We also hold two asset-backed securities collateralized by mortgage loans, which have been fully reserved.

Liabilities for Contingent Consideration

Acquisition-related liabilities for contingent consideration (i.e., earnouts) are related to the purchase business combinations of GD in 2017; Optitex Ltd. (“Optitex”) and Rialco Limited (“Rialco”) in 2016; Shuttleworth Business Systems Limited and CDM Solutions Limited (collectively, “Shuttleworth”), CTI, and Reggiani in 2015; DiMS! organizing print BV (“DiMS”), DirectSmile GmbH (“DirectSmile”), and SmartLinc, Inc. (“SmartLinc”) in 2014; Outback Software Pty. Ltd. doing business as Metrix Software (“Metrix”) and PrintLeader Software (“PrintLeader”) in 2013.

The fair value of these earnouts is estimated to be \$53.5 and \$56.5 million as of September 30, 2017, and December 31, 2016, respectively, by applying the income approach in accordance with ASC 805-30-25-5. Key assumptions include risk-free discount rates between 0.6% and 4.98% (Monte Carlo valuation method) and discount rates between 4.7% and 6.0% (probability-adjusted method), as well as probability-adjusted revenue and earnings before interest and taxes (“EBIT”) levels. Probability-adjusted revenue, gross profit, operating profit, and EBIT are significant inputs that are not observable in the market, which ASC 820-10-35 refers to as Level 3 inputs. These contingent liabilities have been reflected in the Condensed Consolidated Balance Sheet as of September 30, 2017, as current and noncurrent liabilities of \$29.6 and \$23.9 million, respectively.

[Table of Contents](#)

The fair value of contingent consideration increased by \$2.2 million, including \$1.2 million of earnout interest accretion related to all acquisitions during the nine months ended September 30, 2017. The Optitex and CTI earnout performance probabilities increased while the Shuttleworth earnout performance probability decreased in 2017. The fair value of contingent consideration increased by \$6.8 million, including \$2.7 million of earnout interest accretion related to all acquisitions during the year ended December 31, 2016. The Rialco, Optitex, Reggiani, DirectSmile, and CTI earnout performance probabilities increased while the DIMS and Shuttleworth earnout performance probabilities decreased or were not achieved in 2016. In accordance with ASC 805-30-35-1, changes in the fair value of contingent consideration subsequent to the acquisition date have been recognized in general and administrative expense.

Earnout payments and settlements during the nine months ended September 30, 2017 of \$8.9, \$1.3, and \$1.2 million are primarily related to the previously accrued Reggiani, Rialco, and Shuttleworth contingent consideration liabilities, respectively. Earnout payments during the year ended December 31, 2016 of \$23.8, \$3.6, \$0.4, and \$0.2 million are primarily related to the previously accrued Reggiani, DirectSmile, SmartLinc, and Metrix contingent consideration liabilities, respectively.

Changes in the fair value of contingent consideration are summarized as follows (in thousands):

Fair value of contingent consideration at January 1, 2016	\$ 54,796
Fair value of Rialco contingent consideration at March 1, 2016	2,109
Fair value of Optitex contingent consideration at June 16, 2016	22,300
Changes in valuation	6,813
Payments	(28,111)
Foreign currency adjustment	(1,444)
Fair value of contingent consideration at December 31, 2016	\$ 56,463
Fair value of GD contingent consideration at August 14, 2017	\$ 3,600
Changes in valuation	\$ 2,187
Payments and settlements	(11,559)
Foreign currency adjustment	2,829
Fair value of contingent consideration at September 30, 2017	<u>\$ 53,520</u>

Since the primary inputs to the fair value measurement of contingent consideration liability are the discount rate and probability-adjusted revenue, we reviewed the sensitivity of the fair value measurement to changes in these inputs. We assessed the probability of achieving the revenue performance targets for contingent consideration associated with each acquisition at percentage levels between 60% and 100% as of each respective acquisition date based on an assessment of the historical performance of each acquired entity, our current expectations of future performance, and other relevant factors. A change in probability-adjusted revenue of five percentage points from the level assumed in the current valuations would result in an increase in the fair value of contingent consideration of \$1.7 million or a decrease in the fair value of contingent consideration of \$2.8 million, resulting in a corresponding adjustment to general and administrative expense. A change in the discount rate of one percentage point would result in an increase in the fair value of contingent consideration of \$0.4 million or a decrease of \$0.5 million. The potential undiscounted amount of future contingent consideration cash payments that we could be required to make related to our business acquisitions, beyond amounts currently accrued, is \$13.5 million as of September 30, 2017.

Fair Value of Derivative Instruments

We utilize the income approach to measure the fair value of our derivative assets and liabilities. The income approach uses pricing models that rely on market observable inputs such as yield curves, currency exchange rates, and forward prices, and are therefore classified as Level 2 measurements. The notional amount of our derivative assets and liabilities was \$191.8 and \$161.8 million as of September 30, 2017 and December 31, 2016, respectively. The fair value of our derivative assets and liabilities that were designated for cash flow hedge accounting treatment having notional amounts of \$3.8 and \$3.2 million as of September 30, 2017 and December 31, 2016, respectively, was not material.

Fair Value of Convertible Senior Notes

In September 2014, we issued \$345 million aggregate principal amount of our Notes. The Notes are carried at their original issuance value, net of unamortized debt discount, and are not marked to market each period. The fair value of the Notes as of September 30, 2017 was approximately \$360.9 million and was considered a Level 2 fair value measurement. Fair value was estimated based upon actual quotations obtained at the end of the reporting period or the most recent date available. A substantial portion of the market value of our Notes in excess of the outstanding principal amount relates to the conversion premium.

6. Convertible Senior Notes (“Notes”), Note Hedges, and Warrants

0.75% Convertible Senior Notes Due 2019

In September 2014, we completed a private placement of \$345 million principal amount of 0.75% Convertible Senior Notes due 2019 (“Notes”). The Notes were sold to the initial purchasers for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from this offering were approximately \$336.3 million, after deducting the initial purchasers’ commissions and the offering expenses paid by us. We used approximately \$29.4 million of the net proceeds to purchase the Note Hedges described below, net of the proceeds from the Warrant transactions also described below.

The Notes are senior unsecured obligations of EFI with interest payable semiannually in arrears on March 1 and September 1 of each year, commencing March 1, 2015. The Notes are not callable and will mature on September 1, 2019, unless previously purchased or converted in accordance with their terms prior to such date. Holders of the Notes who convert in connection with a “fundamental change,” as defined in the indenture governing the Notes (“Indenture”), may require us to purchase for cash all or any portion of their Notes at a purchase price equal to 100 percent of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any.

The initial conversion rate is 18.9667 shares of common stock per \$1,000 principal amount of Notes, which is equivalent to an initial conversion price of approximately \$52.72 per share of common stock. Upon conversion of the Notes, holders will receive cash, shares of common stock or a combination thereof, at our election. Our intent is to settle the principal amount of the Notes in cash upon conversion. If the conversion value exceeds the principal amount, we would deliver shares of our common stock for our conversion obligation in excess of the aggregate principal amount. As of September 30, 2017, none of the conditions listed below allowing holders of the Notes to convert had been met.

Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Holders may convert their Notes only under the following circumstances:

- if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any five consecutive trading day period (“Notes Measurement Period”) in which the “trading price” (as the term is defined in the Indenture) per \$1,000 principal amount of Notes for each trading day of such Notes Measurement Period was less than 98% of the product of the last reported stock price on such trading day and the conversion rate on each such trading day;
- upon the occurrence of specified corporate events; or
- at any time on or after March 1, 2019 until the close of business on the second scheduled trading day immediately preceding the maturity date.

We separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the estimated fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount (“debt discount”) is amortized to interest expense over the term of the Notes using the effective interest method with an effective interest rate of 4.98% per annum (5.46% inclusive of debt issuance costs). The equity component is not remeasured if it continues to meet the conditions for equity classification.

[Table of Contents](#)

We allocated the total transaction costs incurred by the Notes issuance to the liability and equity components based on their relative values. Issuance costs of \$7.0 million attributable to the \$281.4 million liability component are being amortized to expense over the term of the Notes, and issuance costs of \$1.6 million attributable to the \$63.6 million equity component were offset against the equity component in stockholders' equity. Additionally, we recorded a deferred tax liability of \$23.7 million on the debt discount, which is not deductible for tax purposes.

The Notes consist of the following as of September 30, 2017, and December 31, 2016 (in thousands):

	September 30, 2017	December 31, 2016
Liability component	\$ 345,000	\$ 345,000
Debt discount, net of amortization	(26,488)	(36,115)
Debt issuance costs, net of amortization	(3,258)	(4,401)
Net carrying amount	<u>\$ 315,255</u>	<u>\$ 304,484</u>
Equity component	\$ 63,643	\$ 63,643
Less: debt issuance costs allocated to equity	(1,582)	(1,582)
Net carrying amount	<u>\$ 62,061</u>	<u>\$ 62,061</u>

Interest expense recognized related to the Notes during the three and nine months ended September 30, 2017 and 2016 was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
0.75% coupon	\$ 647	\$ 654	\$ 1,933	\$ 1,941
Amortization of debt issuance costs	388	373	1,144	1,092
Amortization of debt discount	3,265	3,126	9,627	9,152
	<u>\$ 4,300</u>	<u>\$ 4,153</u>	<u>\$ 12,704</u>	<u>\$ 12,185</u>

Note Hedges

We paid an aggregate of \$63.9 million in convertible note hedge transactions with respect to our common stock ("Note Hedges") in September 2014. The Note Hedges will expire upon maturity of the Notes. The Note Hedges are intended to offset the potential dilution upon conversion and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of the Notes in the event that the market value per share of our common stock, as measured under the terms of the Note Hedges, is greater than the strike price of the Note Hedges. The strike price of the Note Hedges initially corresponds to the conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion price of the Notes. The Note Hedges are separate transactions and are not part of the Notes. Holders of the Notes will not have any rights with respect to the Note Hedges.

Warrants

Concurrently with entering into the Note Hedges, we separately entered into warrant transactions ("Warrants"), whereby we sold Warrants to acquire shares of our common stock at a strike price of \$68.86 per share. We received aggregate proceeds of \$34.5 million from the sale of the Warrants. If the average market value per share of our common stock for the reporting period, as measured under the Warrants, exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on our earnings per share. The Warrants are separate transactions and are not part of the Notes or the Note Hedges and are accounted for as a component of additional paid-in capital. Holders of the Notes and Note Hedges will not have any rights with respect to the Warrants.

7. Income taxes

We recognized tax provisions of \$0.8 million on pretax net income of \$4.2 and \$11.8 million during the three and nine months ended September 30, 2017, respectively. We recognized tax benefits of \$11.8 and \$9.0 million on pretax net income of \$5.8 and \$16.0 million during the three and nine months ended September 30, 2016, respectively. The provisions for income taxes before discrete items reflected in the table below were \$1.9 and \$4.5 million during the three and nine months ended September 30, 2017, respectively, and \$3.3 and \$6.1 million during the three and nine months ended September 30, 2016, respectively. The decrease in the provisions for income taxes before discrete items for the three and nine months ended September 30, 2017, compared with the same periods in the prior year, is primarily due to decreased profitability before income taxes.

Primary differences between our provision for income taxes before discrete items and the income tax provision at the U.S. statutory rate of 35% include lower taxes on permanently reinvested foreign earnings, the tax effects of stock-based compensation expense pursuant to ASC 718-740, Stock Compensation – Income Taxes, which are non-deductible for tax purposes, and tax benefits from significantly lower reversal of uncertain tax positions in 2017 as compared to those recorded in 2016.

Our tax provisions before discrete items are reconciled to our recorded benefits for income taxes during the three and nine months ended September 30, 2017 and 2016 as follows (in millions):

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Provision for income taxes before discrete items	\$ 1.9	\$ 3.3	\$ 4.5	\$ 6.1
Interest related to unrecognized tax benefits	—	—	0.1	0.3
Reassessment of taxes upon filing tax returns	0.3	(0.2)	0.4	(0.2)
Provision (benefit) related to stock based compensation, including ESPP dispositions	0.4	(1.4)	(1.9)	(1.7)
Benefit from reassessment of taxes upon foreign statutory tax rate change	—	—	(0.5)	—
Benefit from reversals of uncertain tax positions due to statute of limitation expirations	(1.8)	(13.5)	(1.8)	(13.5)
Benefit from income taxes	<u>\$ 0.8</u>	<u>\$ (11.8)</u>	<u>\$ 0.8</u>	<u>\$ (9.0)</u>

As of September 30, 2017, and December 31, 2016, gross unrecognized benefits that would affect the effective tax rate if recognized were \$32.3 and \$32.0 million, respectively. Over the next twelve months, our existing tax positions will continue to generate increased liabilities for unrecognized tax benefits. It is reasonably possible that our gross unrecognized tax benefits will decrease up to \$5.0 million in the next twelve months primarily due to the lapse of the statute of limitations for federal and state tax purposes. These adjustments, if recognized, would positively impact our effective tax rate, and would be recognized as additional tax benefits in our Condensed Consolidated Statements of Operations.

In accordance with ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, Similar Tax Loss, or Tax Credit Carryforward Exists, \$19.9 million of gross unrecognized tax benefits were offset against deferred tax assets as of September 30, 2017, and the remaining \$12.4 million has been recorded as noncurrent income taxes payable.

We recognize potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of September 30, 2017 and December 31, 2016, we have accrued \$0.6 and \$0.5 million, respectively, for potential payments of interest and penalties.

We are subject to examination by the Internal Revenue Service (“IRS”) for the 2014-2015 tax years, state tax jurisdictions for the 2012-2015 tax years, the Netherlands tax authority for the 2012-2015 tax years, the Spanish tax authority for the 2013-2016 tax years, the Israel tax authority for the 2011-2015 tax years, and the Italian tax authority for the 2012-2015 tax years.

8. Commitments and Contingencies

Contingent Consideration

We are required to make payments to the former stockholders of acquired companies based on the achievement of specified performance targets as more fully explained in Note 5 – Investments and Fair Value Measurements.

[Table of Contents](#)

Lease Commitments and Contractual Obligations

As of September 30, 2017, we have leased certain of our current facilities under noncancellable operating lease agreements. We are required to pay property taxes, insurance, and nominal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

Assets Held for Sale

In 2016, management approved a plan to sell approximately 5.6 acres and the office building located at 1340 Corporate Center Curve, Eagan, Minnesota, consisting of 43,682 square feet, and the related fixed assets were classified as held for sale. On April 13, 2017, we entered into an agreement under which we agreed to sell the office building and related land, subject to completion of a 150-day due diligence period, which expired without the transaction closing on September 7, 2017. Accordingly, assets previously recorded as held for sale of \$3.8 million, which consisted of \$2.9 million net book value of the facility and \$0.9 million of related land as of December 31, 2016, have been classified as assets held for use within property and equipment, net, in our Condensed Consolidated Balance Sheet as of September 30, 2017.

Off-Balance Sheet Financing – Lease Arrangements

On August 26, 2016, we entered into a lease agreement and have accounted for a lease term of 48.5 years, inclusive of two renewal options of 5.0 and 3.5 years, with the City of Manchester to lease 16.9 acres adjacent to the Manchester Regional Airport. The land is subleased to Bank of Tokyo – Mitsubishi UFJ Leasing & Finance LLC (“BTMU”) during the term of the lease related to the manufacturing facility that is being constructed on the site, which is described below. Minimum lease payments are \$13.1 million during the 48.5 year term of the land lease, excluding four months of the land lease that are financed into the manufacturing facility lease.

On August 26, 2016, we entered into a six-year lease with BTMU whereby a 225,000 square foot manufacturing and warehouse facility is under construction related to our super-wide format industrial digital inkjet printer business in the Industrial Inkjet operating segment at a projected cost of \$40 million and a construction period of 18 months. Minimum lease payments during the initial six-year term are \$1.8 million. Upon completion of the initial six-year term, we have the option to renew the lease, purchase the facility, or return the facility to BTMU subject to an 89% residual value guarantee under which we would recognize additional rent expense in the form of a variable rent payment. We have assessed our exposure in relation to the residual value guarantee and believe that there is no deficiency to the guaranteed value with respect to funds expended by BTMU as of September 30, 2017. We are treated as the owner of the facility for federal income tax purposes.

The funds pledged under the lease represent 115% of the total expenditures made by BTMU through September 30, 2017. The funds are invested in \$20.9 and \$6.8 million of U.S. government securities and cash equivalents, respectively, with a third party trustee and will be restricted during the construction period. Upon completion of construction, the funds will be released as cash and cash equivalents. The portion of released funds that represents 100% of the total expenditures made by BTMU will be deposited with BTMU and restricted as collateral until the end of the underlying lease period.

The funds pledged as collateral are invested in U.S. government securities and cash equivalents as of September 30, 2017, and are classified as Level 1 in the fair value hierarchy as more fully defined in Note 5 – Investments and Fair Value Measurements. Net unrealized gains of less than \$0.1 million were included in OCI in the accompanying Condensed Consolidated Balance Sheet as of September 30, 2017.

We have determined that the lease agreement does not qualify as a variable interest entity under ASC 810-10, Consolidation, and as such, we are not required to consolidate the VIE in our condensed consolidated financial statements.

Legal Proceedings

We may be involved, from time to time, in a variety of claims, lawsuits, investigations, or proceedings relating to contractual disputes, securities laws, intellectual property rights, employment, or other matters that may arise in the normal course of business. We assess our potential liability in each of these matters by using the information available to us. We develop our views on estimated losses in consultation with inside and outside counsel, which involves a subjective analysis of potential results and various combinations of appropriate litigation and settlement strategies. We accrue estimated losses from contingencies if a loss is deemed probable and can be reasonably estimated.

[Table of Contents](#)

As of September 30, 2017, we are subject to the matters discussed below:

Matan Digital Printing (“MDG”) Matter

EFI acquired Matan Digital Printers (“Matan”) in 2015 from sellers (the “2015 Sellers”) that acquired Matan Digital Printing Ltd. from other sellers in 2001 (the “2001 Sellers”). The 2001 Sellers have asserted a claim against the 2015 Sellers and Matan asserting that they are entitled to a portion of the 2015 Sellers’ proceeds from EFI’s acquisition. The 2015 Sellers dispute this claim and have agreed to indemnify EFI against the 2001 Sellers’ claim.

Although we are fully indemnified and we do not believe that it is probable that we will incur a loss, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Accordingly, it is reasonably possible that we could incur a material loss in this matter. We estimate the range of loss to be between one dollar and \$10.1 million. If we incur a loss in this matter, it will be offset by a receivable of an equal amount representing a claim for indemnification against the escrow account established in connection with the Matan acquisition.

Purported Class Action Lawsuit

On August 10, 2017, a putative class action was filed against the Company and its two named executive officers in the United States District Court for the District of New Jersey, captioned *Pipitone v. Electronics For Imaging, Inc.*, No. 2:17-cv-05992 (D.N.J.). The complaint alleges, among other things, that statements by the Company and its officers about the Company’s financial reporting, revenue recognition, internal controls, and disclosure controls and procedures were false or misleading. The complaint seeks an unspecified amount of damages, interest, attorneys’ fees, and other costs, on behalf of a putative class of individuals and entities that purchased or otherwise acquired EFI securities from February 22, 2017 through August 3, 2017.

At this time, we do not believe it is probable that we will incur a material loss in this matter. However, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Because this matter is in the preliminary stages, we are not yet in a position to estimate the amount or range of reasonably possible loss that may be incurred.

Purported Derivative Shareholder Lawsuits

On August 22, 2017, a purported derivative shareholder complaint was filed in the Superior Court of the State of California for the County of Alameda captioned *Schiffmiller v. Gecht*, No. RG17873197. The complaint makes claims derivatively and on behalf of the Company as nominal defendant against the Company’s named executive officers and directors for alleged breaches of fiduciary duties and unjust enrichment, and alleges, among other things, that statements by the Company and its officers about the Company’s financial reporting, revenue recognition, internal controls, and disclosure controls and procedures were false or misleading. The complaint alleges the Company has suffered damage as a result of the individual defendants’ alleged actions, and seeks an unspecified amount of damages, restitution, and declaratory and other relief. The derivative action has been stayed pending the resolution of the *Pipitone* class action described above.

At this time, we do not believe it is probable that we will incur a material loss in this matter. However, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Because this matter has been stayed pending resolution of the *Pipitone* class action described above, we are not yet in a position to estimate the amount or range of reasonably possible loss that may be incurred.

Other Matters

As of September 30, 2017, we were subject to various other claims, lawsuits, investigations, and proceedings in addition to the matter discussed above. There is at least a reasonable possibility that additional losses may be incurred in excess of the amounts that we have accrued. However, we believe that these claims are not material to our financial statements or the range of reasonably possible losses is not reasonably estimable. Litigation is inherently unpredictable, and while we believe that we have valid defenses with respect to legal matters pending against us, our financial statements could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies or because of the diversion of management’s attention and the incurrence of significant expenses.

9. Segment Information and Geographic Data

Operating segment information is required to be presented based on the internal reporting used by the chief operating decision making group (“CODM”) to allocate resources and evaluate operating segment performance. Our CODM is comprised of our Chief Executive Officer and Chief Financial Officer. The CODM group is focused on assessment and resource allocation among the Industrial Inkjet, Productivity Software, and Fiery operating segments.

Our operating segments are integrated through their reporting and operating structures, shared technology and practices, shared sales and marketing, and combined production facilities. Our enterprise management processes use financial information that is closely aligned with our three operating segments at the gross profit level. Relevant discrete financial information is prepared at the gross profit level for each of our three operating segments, which is used by the CODM to allocate resources and assess the performance of each operating segment.

We classify our revenue, operating segment profit (i.e., gross profit), assets, and liabilities in accordance with our operating segments as follows:

Industrial Inkjet, which consists of our VUTEk and Matan super-wide and wide format display graphics, Reggiani textile, Jetrion label and packaging, Nozomi corrugated packaging, and Cretaprint ceramic tile decoration and construction material industrial digital inkjet printers; digital ultra-violet (“UV”) curable, light-emitting diode (“LED”) curable, ceramic, water-based, and thermoforming ink, as well as a variety of textile ink including dye sublimation, pigmented, reactive dye, acid dye, pure disperse dye, and water-based dispersed printing ink; digital inkjet printer parts; and professional services. Printing surfaces include paper, vinyl, corrugated, textile, glass, plastic, aluminum composite, ceramic tile, wood, and many other flexible and rigid substrates.

Productivity Software, which consists of a complete software suite that enables efficient and automated end-to-end business and production workflows for the print and packaging industry. This *Productivity Suite* also provides tools to enable revenue growth, efficient scheduling, and optimization of processes, equipment, and personnel. Customers are provided the financial and technical flexibility to deploy locally within their business or to be hosted in the cloud. The Productivity Suite addresses all segments of the print industry and consists of the: (i) *Packaging Suite*, with Radius at its core, for tag & label, cartons, and flexible packaging businesses; (ii) *Corrugated Packaging Suite*, with CTI at its core, for corrugated packaging businesses; (iii) *Enterprise Commercial Print Suite*, with Monarch at its core, for enterprise print businesses; (iv) *Publication Print Suite*, with Monarch or Technique at its core, for publication print businesses; (v) *Midmarket Print Suite*, with Pace at its core, for medium size print businesses; (vi) *Quick Print Suite*, with PrintSmith at its core, for small printers and in-plant sites; and (vii) *Value Added Products*, available with the suite and standalone, such as web-to-print, e-commerce, cross media marketing, warehousing, fulfillment, shop floor data collection, and shipping to reduce costs, increase profits, and offer new products and services to their existing and future customers. We also market Optitex computer-aided fashion design (“fashion CAD”) software, which facilitates fast fashion and increased efficiency in the textile and fashion industries.

Fiery, which consists of DFEs, including the recently acquired FFPS DFE from Xerox, that transform digital copiers and printers into high performance networked printing devices for the office, industrial, and commercial printing markets. This operating segment is comprised of (i) stand-alone DFEs connected to digital printers, copiers, and other peripheral devices, (ii) embedded DFEs and design-licensed solutions used in digital copiers and multi-functional devices, (iii) optional software integrated into our DFE solutions such as Fiery Central, Generation Digital, and Graphics Arts Package, (iv) Fiery Self Serve, our self-service and payment solution, and (v) stand-alone software-based solutions such as our proofing solutions.

Our CODM evaluates the performance of our operating segments based on net sales and gross profit. Gross profit for each operating segment includes revenue from sales to third parties and related cost of revenue attributable to the operating segment. Cost of revenue for each operating segment excludes certain expenses managed outside the operating segments consisting primarily of stock-based compensation expense.

Operating income is not reported by operating segment because operating expenses include significant shared expenses and other costs that are managed outside of the operating segments. Such operating expenses include various corporate expenses such as stock-based compensation, corporate sales and marketing, research and development, amortization of identified intangibles, various non-recurring charges, and other separately managed general and administrative expenses.

[Table of Contents](#)

Operating segment profit (i.e., gross profit), excluding stock-based compensation expense, during the three and nine months ended September 30, 2017 and 2016 is summarized as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Industrial Inkjet				
Revenue	\$ 142,930	\$ 143,004	\$ 407,886	\$ 408,926
Gross profit	53,392	50,433	154,972	141,927
Gross profit percentages	37.4%	35.3%	38.0%	34.7%
Productivity Software				
Revenue	\$ 37,171	\$ 39,663	\$ 111,292	\$ 108,554
Gross profit	26,667	30,041	81,431	80,961
Gross profit percentages	71.7%	75.7%	73.2%	74.6%
Fiery				
Revenue	\$ 68,258	\$ 62,908	\$ 204,919	\$ 207,878
Gross profit	47,885	45,362	143,821	147,938
Gross profit percentages	70.2%	72.1%	70.2%	71.2%

Operating segment profit (i.e., gross profit) is reconciled to our Condensed Consolidated Statements of Operations during the three and nine months ended September 30, 2017 and 2016 as follows (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2017	2016	2017	2016
Segment gross profit	\$ 127,944	\$ 125,836	\$ 380,224	\$ 370,826
Stock-based compensation expense	(486)	(642)	(1,985)	(1,873)
Other items excluded from segment profit	—	—	—	(315)
Gross profit	<u>\$ 127,458</u>	<u>\$ 125,194</u>	<u>\$ 378,239</u>	<u>\$ 368,638</u>

The Fiery gross profit percentage is impacted by less than \$0.1 and \$1.3 million during the three and nine months ended September 30, 2017, respectively, charged to cost of revenue, which reflects the cost of manufacturing plus a portion of the expected profit margin related to the acquired FFPS inventories. Inventory acquired in the acquisition of FFPS is required to be recorded at fair value rather than historical cost in accordance with ASC 805. This amount is not included in the financial information regularly reviewed by the CODM as this acquisition-related charge is not indicative of the gross margin trends in the FFPS business. Excluding this charge, the Fiery gross profit percentage would be 70.3% and 70.8% for the three and nine months ended September 30, 2017, respectively.

Tangible and intangible assets, net of liabilities, are summarized by operating segment as follows (in thousands):

	Industrial Inkjet	Productivity Software	Fiery	Corporate and Unallocated Net Assets	Total
September 30, 2017					
Goodwill	\$ 149,353	\$ 164,525	\$ 73,123	\$ —	\$ 387,001
Identified intangible assets, net	72,290	32,294	21,983	—	126,567
Tangible assets, net of liabilities	219,554	(35,624)	11,833	129,341	325,104
Net tangible and intangible assets	<u>\$ 441,197</u>	<u>\$ 161,195</u>	<u>\$ 106,939</u>	<u>\$ 129,341</u>	<u>\$ 838,672</u>
December 31, 2016					
Goodwill	\$ 141,068	\$ 155,475	\$ 63,298	\$ —	\$ 359,841
Identified intangible assets, net	84,465	38,440	92	—	122,997
Tangible assets, net of liabilities	153,699	(27,646)	33,966	183,158	343,177
Net tangible and intangible assets	<u>\$ 379,232</u>	<u>\$ 166,269</u>	<u>\$ 97,356</u>	<u>\$ 183,158</u>	<u>\$ 826,015</u>

[Table of Contents](#)

Corporate and unallocated assets consist of cash and cash equivalents, short-term investments, restricted investments and cash equivalents, corporate headquarters facility, convertible notes, imputed financing obligation, income taxes receivable, and income taxes payable.

Geographic Regions

Our revenue originates in the U.S., China, the Netherlands, Germany, Italy, France, the U.K., Spain, Israel, Brazil, India, Australia, and New Zealand. We report revenue by geographic region based on ship-to destination. Shipments to some of our significant printer manufacturer/distributor customers are made to centralized purchasing and manufacturing locations, which in turn sell through to other locations. As a result of these factors, we believe that sales to certain geographic locations might be higher or lower, as the ultimate destinations are difficult to ascertain.

Our revenue by ship-to destination during the three and nine months ended September 30, 2017 and 2016 was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Americas	\$ 129,488	\$ 128,252	\$ 353,397	\$ 363,977
Europe, Middle East and Africa (“EMEA”)	85,089	85,009	274,635	264,469
Asia Pacific (“APAC”)	33,782	32,314	96,065	96,912
Total revenue	<u>\$ 248,359</u>	<u>\$ 245,575</u>	<u>\$ 724,097</u>	<u>\$ 725,358</u>

10. Derivatives and Hedging

We are exposed to market risk and foreign currency exchange risk from changes in foreign currency exchange rates, which could affect operating results, financial position, and cash flows. We manage our exposure to these risks through our regular operating and financing activities and, when appropriate, through use of derivative financial instruments. These derivative financial instruments are used to hedge monetary assets and liabilities, intercompany balances, trade receivables, anticipated cash flows, and to reduce earnings and cash flow volatility resulting from shifts in market rates. Our objective is to offset gains and losses resulting from these exposures with losses and gains on the derivative contracts used to hedge them, thereby reducing volatility of earnings or protecting fair values of assets and liabilities. We do not have any leveraged derivatives, nor do we use derivative contracts for speculative purposes. ASC 815, Derivatives and Hedging, requires the fair value of all derivative instruments, including those embedded in other contracts, to be recorded as assets or liabilities in our Condensed Consolidated Balance Sheet. The related cash flow impacts of our derivative contracts are reflected as cash flows from operating activities.

Our exposures are primarily related to non-U.S. dollar-denominated revenue in Europe, the U.K., Latin America, China, Israel, Australia, New Zealand, and Canada, and to non-U.S. dollar-denominated operating expenses in Europe, India, Japan, the U.K., China, Israel, Brazil, and Australia. We hedge our operating expense cash flow exposure in Indian rupees. We hedge balance sheet remeasurement exposure associated with British pound sterling, Brazilian real, Israeli shekel, Japanese yen, Chinese renminbi, and Euro-denominated intercompany balances; Brazilian real, British pound sterling, Australian dollar, Canadian dollar, Israeli shekel, and Euro-denominated trade receivables; and British pound sterling, Indian rupee, Israeli shekel, Canadian dollar, and Euro-denominated net monetary assets.

By their nature, derivative instruments involve, to varying degrees, elements of market and credit risk. The market risk associated with these instruments resulting from currency exchange movement is expected to offset the market risk of the underlying transactions, assets, and liabilities being hedged (i.e., operating expense exposure in Indian rupees; the collection of trade receivables denominated in currencies other than their respective reporting entity’s functional currency, and the settlement of intercompany balances denominated in currencies other than their functional currency). Under our master netting agreements with our foreign currency derivative counterparties, we are allowed to net transactions of the same currency with a single net amount payable by one party to the other. The derivatives held by us are not subject to any credit contingent features negotiated with these counterparties. We are not required to pledge cash collateral related to these foreign currency derivative contracts. We do not believe there is significant risk of loss from non-performance by the counterparty associated with these instruments because, by policy, we deal with counterparties having a minimum investment grade or better credit rating. Credit risk is managed through the continuous monitoring of exposures to such counterparties.

[Table of Contents](#)*Cash Flow Hedges*

Foreign currency derivative contracts with notional amounts of \$3.8 million and \$3.2 million have been designated as cash flow hedges of our Indian rupee operating expense exposure at September 30, 2017 and December 31, 2016, respectively. The fair value of the net assets (liabilities) related to these cash flow hedges are not material. The changes in fair value of these contracts are reported as a component of OCI and reclassified to operating expense in the periods of payment of the hedged operating expenses. The amount of ineffectiveness that was recorded in the Condensed Consolidated Statements of Operations for these designated cash flow hedges was immaterial. All components of each derivative's gain or loss were included in the assessment of hedge effectiveness.

Balance Sheet Hedges

Forward contracts not designated for hedge accounting treatment with notional amounts of \$188.0 and \$158.7 million are used to hedge foreign currency balance sheet exposures at September 30, 2017 and December 31, 2016, respectively. They are not designated for hedge accounting treatment since there is a natural offset for the remeasurement of the underlying foreign currency denominated asset or liability. We recognize changes in the fair value of non-designated derivative instruments in earnings in the period of change. Gains and losses on foreign currency forward contracts used to hedge balance sheet exposures are recognized in interest income and other income, net, in the same period as the remeasurement gain or loss of the related foreign currency denominated assets and liabilities. Forward contracts not designated for hedge accounting treatment consist of hedges of British pound sterling, Brazilian real, Israeli shekel, Japanese yen, Chinese renminbi, and Euro-denominated intercompany balances with notional amounts of \$99.6 and \$90.7 million; hedges of Brazilian real, British pound sterling, Australian dollar, Canadian dollar, Israeli shekel, and Euro-denominated trade receivables with notional amounts of \$46.5 and \$39.8 million; and hedges of British pounds sterling, Indian rupee, Israeli shekel, Canadian dollar, and Euro-denominated other net monetary assets with notional amounts of \$41.9 and \$28.2 million at September 30, 2017 and December 31, 2016, respectively.

11. Restructuring and Other

During the three and nine months ended September 30, 2017 and 2016, cost reduction actions were taken to lower our operating expense run rate as we analyze and re-align our cost structure following our business acquisitions. These charges primarily relate to integrating recently acquired businesses, consolidating facilities, and lowering our operating expense run rate. Restructuring and other consists primarily of restructuring, severance, retention, facility downsizing and relocation, and acquisition integration expenses. Our restructuring and other plans are accounted for in accordance with ASC 420, Exit or Disposal Cost Obligations, ASC 712, Compensation – Non-Retirement Postemployment Benefits, and ASC 820.

Restructuring and other costs were \$0.8 and \$5.4 million during the three and nine months ended September 30, 2017, respectively, and \$1.3 and \$5.7 million during the three and nine months ended September 30, 2016, respectively. Restructuring and other costs include severance charges of \$0.3 and \$3.8 million related to reductions in head count of 15 and 128 during the three and nine months ended September 30, 2017, respectively, and \$0.6 and \$3.7 million related to reduction in head count of 16 and 114 during the three and nine months ended September 30, 2016, respectively. Severance costs include severance payments, related employee benefits, outplacement fees, and employee relocation costs.

Facilities relocation and downsizing expenses were \$0.4 and \$0.6 million during the three and nine months ended September 30, 2017, respectively, and \$0.1 and \$0.6 million during the three and nine months ended September 30, 2016, primarily related to the relocation of certain administrative locations due to reduced space requirements. Integration expenses of \$0.2 and \$1.0 million during the three and nine months ended September 30, 2017, respectively, and \$0.6 and \$1.5 million during the three and nine months ended September 30, 2016, respectively, were required to integrate our business acquisitions.

Restructuring and other reserve activities during the nine months ended September 30, 2017 and 2016 are summarized as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Reserve balance at January 1,	\$ 1,824	\$ 3,019
Restructuring charges	4,101	2,878
Other charges	1,321	2,856
Non-cash restructuring and other	(182)	(403)
Cash payments	<u>(4,720)</u>	<u>(6,174)</u>
Reserve balance at September 30,	<u>\$ 2,344</u>	<u>\$ 2,176</u>

12. Stock-based Compensation

We account for stock-based payment awards in accordance with ASC 718, Stock Compensation, which requires the measurement and recognition of compensation expense for all equity awards granted to our employees and directors, including RSUs, ESPP purchase rights, and employee stock options related to all stock-based compensation plans based on the fair value of such awards on the date of grant. We amortize stock-based compensation cost on a graded vesting basis over the vesting period reduced by actual forfeitures, after assessing the probability of achieving the requisite performance criteria with respect to performance-based awards. Stock-based compensation cost is recognized over the requisite service period for each separately vesting tranche of the award as though the award were, in substance, multiple awards.

Stock-based compensation expense related to stock options, ESPP purchase rights, and RSUs during the three and nine months ended September 30, 2017 and 2016 is summarized as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Stock-based compensation expense by type of award:				
RSUs	\$ 3,545	\$ 7,979	\$ 18,875	\$ 24,931
ESPP purchase rights	1,103	574	3,666	1,932
Employee stock options	—	—	—	79
Total stock-based compensation	4,648	8,553	22,541	26,942
Income tax benefit	(1,525)	(3,649)	(6,929)	(7,895)
Stock-based compensation expense, net of tax	\$ 3,123	\$ 4,904	\$ 15,612	\$ 19,047

Valuation Assumptions for Stock Options and ESPP Purchase Rights

We use the Black-Scholes-Merton (“BSM”) option pricing model to value stock-based compensation for all equity awards, except market-based awards, which are valued using the Monte Carlo valuation model.

The BSM model determines the fair value of stock-based payment awards based on the stock price on the date of grant and is affected by assumptions regarding highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, expected term, interest rates, and actual and projected employee stock option exercise behavior. Expected volatility is based on the historical volatility of our stock over a preceding period commensurate with the expected term of the option. The expected term is based upon management’s consideration of the historical life, vesting period, and contractual period of the options granted. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividend yield was not considered in the option pricing formula since we do not pay dividends and have no current plans to do so in the future.

Stock options were not granted during the three and nine months ended September 30, 2017 and 2016. The estimated weighted average fair value per share of ESPP purchase rights issued and the underlying weighted average assumptions for the three and nine months ended September 30, 2017 and 2016 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Weighted average fair value per share	\$ 13.14	\$ 12.00	\$ 12.09	\$ 10.69
Expected volatility	25% - 28%	26% - 32%	24% - 28%	22% - 32%
Risk-free interest rate	1.2% - 1.3%	0.4% - 0.7%	0.7% - 1.3%	0.4% - 0.8%
Expected term (in years)	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0

[Table of Contents](#)

Stock options outstanding and exercisable, including performance-based and market-based options, as of September 30, 2017, and activity during the nine months ended September 30, 2017 are summarized below (in thousands, except weighted average exercise price and remaining contractual term):

	Shares outstanding	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value
Options outstanding at January 1, 2017	315	\$ 13.86		
Options exercised	(140)	12.22		
Options outstanding at September 30, 2017	175	\$ 15.18	1.32	\$ 4,812
Options vested and expected to vest at September 30, 2017	175	\$ 15.18	1.32	\$ 4,812
Options exercisable at September 30, 2017	175	\$ 15.18	1.32	\$ 4,812

Aggregate intrinsic value for stock options represents the difference between the closing price per share of our common stock on the last trading day of the fiscal period and the option exercise price multiplied by the number of in-the-money stock options outstanding, vested and expected to vest, and exercisable at September 30, 2017.

Non-vested RSUs as of September 30, 2017, and activity during the nine months ended September 30, 2017 are summarized below (shares in thousands):

	Time-based		Performance-based		Market-based		Total	
	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value
Non-vested at January 1, 2017	795	\$ 43.79	1,265	\$ 42.64	23	\$ 33.16	2,083	\$ 43.34
Granted	120	45.98	371	46.93	—	—	491	46.70
Vested	(417)	43.88	(276)	40.83	—	—	(693)	42.66
Forfeited	(49)	43.72	(437)	41.29	—	—	(486)	41.53
Non-vested at September 30, 2017	449	\$ 44.30	923	\$ 45.55	23	\$ 33.16	1,395	\$ 45.49

Vested RSUs

Performance-based RSUs that vested based on financial results are included in “Vested RSUs” in the table above in the period that the performance and related service criteria were met. The grant date fair value of RSUs vested during the nine months ended September 30, 2017 was \$29.6 million. The aggregate intrinsic value at September 30, 2017 for RSUs expected to vest was \$34.1 million and the remaining weighted average vesting period was 1.0 year. Aggregate intrinsic value for RSUs vested and expected to vest represents the closing price per share of our common stock on the last trading day of the fiscal period, multiplied by the number of RSUs vested and expected to vest as of September 30, 2017. RSUs expected to vest represent time-based RSUs unvested and outstanding at September 30, 2017, and performance-based RSUs for which the requisite service period has not been rendered, but are expected to vest based on the achievement of performance conditions.

Performance-based and Market-based RSUs and Stock Options

Performance-based stock options, market-based RSUs, and market-based stock options were not granted during the nine months ended September 30, 2017 and 2016. We use the BSM option pricing model to value performance-based RSUs. The weighted average grant date fair value per share of performance-based RSUs granted and the assumptions used to estimate grant date fair value during the nine months ended September 30, 2017 and 2016 are as follows:

	Performance-based RSUs	
	Short-term	Long-term
Nine months ended September 30, 2017 Grants		
Grant date fair value per share	\$ 47.23	\$ 45.96
Service period (years)	1.0	2.0 - 3.0
Nine months ended September 30, 2016 Grants		
Grant date fair value per share	\$ 39.79	\$ 45.62
Service period (years)	1.0	2.0 - 3.0

[Table of Contents](#)

Our performance-based RSUs generally vest when specified performance criteria are met based on bookings, revenue, cash provided by operating activities, non-GAAP operating income, non-GAAP earnings per share, revenue growth compared to market comparables, non-GAAP earnings per share growth compared to cash flow from operating activities growth, or other targets during the service period; otherwise, they are forfeited. Non-GAAP operating income is defined as operating income determined in accordance with GAAP, adjusted to remove the impact of certain expenses and gains. Non-GAAP earnings per share is defined as net income determined in accordance with GAAP, adjusted to remove the impact of certain expenses and gains, and the related tax effects, divided by the weighted average number of common shares and dilutive potential common shares outstanding during the period as more fully defined in Note 2 – Earnings Per Share of the Notes to Condensed Consolidated Financial Statements.

The grant date fair value per share determined in accordance with the BSM valuation model is being amortized over the service period of the performance-based awards. The probability of achieving the awards was determined based on review of the actual results achieved thus far by each business unit compared with the operating plan during the pertinent service period as well as the overall strength of the business unit. Stock-based compensation expense was adjusted based on this probability assessment. As actual results are achieved during the service period, the probability assessment is updated and stock-based compensation expense adjusted accordingly.

Market-based awards that were granted in prior periods vest when our average closing stock price exceeds defined multiples of the closing stock price for 90 consecutive trading days. If these multiples were not achieved by the expiration date, the awards are forfeited. The grant date fair value is being amortized over the average derived service period of the awards. The average derived service period and total fair value were determined using a Monte Carlo valuation model based on our assumptions, which include a risk-free interest rate and implied volatility.

2017 Equity Incentive Plan

Our stockholders approved the 2017 Equity Incentive Plan (“2017 Plan”) on June 7, 2017, which includes:

- 1.2 million shares of our common stock reserved for issuance pursuant to such plan;
- 1,593,660 common stock shares that were available for future grants under the 2009 Equity Incentive Award Plan (“Prior Plan”) immediately prior to termination of authority to grant new awards under the Prior Plan on June 7, 2017;
- shares subject to stock options granted under the Prior Plan and outstanding as of June 7, 2017, which expire, or for any reason are cancelled or terminated, after that date without being exercised; and
- shares subject to restricted stock unit awards granted under the Prior Plan that are outstanding and unvested as of June 7, 2017 which are forfeited, terminated, cancelled, or otherwise reacquired after that date without having become vested.

No additional grants will be made under the Prior Plan. The 2017 Plan replaces the Prior Plan and will be used to help attract, retain and motivate employees, consultants, and directors.

13. Common Stock Repurchase Programs

On November 9, 2015, the board of directors approved the repurchase of \$150 million of outstanding common stock commencing January 1, 2016. On September 11, 2017, the board of directors approved the repurchase of an additional \$125 million for our share repurchase program commencing September 11, 2017. At that time, \$28.8 million remained available for repurchase under the 2015 authorization. The 2017 authorization thereby increased the repurchase authorization to \$153.8 million of our common stock. This authorization expires December 31, 2018. Under this publicly announced plan, we repurchased 0.3 and 1.0 million shares for an aggregate purchase price of \$12.5 and \$47.0 million during the three and nine months ended September 30, 2017, respectively. We repurchased 0.4 and 1.4 million shares for an aggregate purchase price of \$18.0 and \$57.7 million during the nine months ended September 30, 2016, respectively.

Our employees have the option to surrender shares of common stock to satisfy their tax withholding obligations that arise on the vesting of RSUs. In connection with stock option exercises, certain employees can surrender shares to satisfy the exercise price of certain stock options and any tax withholding obligations incurred in connection with such exercises. Employees surrendered less than 0.1 and 0.2 million shares for an aggregate purchase price of \$3.1 and \$10.0 million during the three and nine months ended September 30, 2017, respectively, and less than 0.1 and 0.2 million shares for an aggregate purchase price of \$3.4 and \$7.6 million during the three and nine months ended September 30, 2016, respectively.

[Table of Contents](#)

These repurchased shares reduce shares outstanding and are recorded as treasury stock under the cost method thereby reducing stockholders' equity by the cost of the repurchased shares. Our repurchase program is limited by SEC regulations and is subject to compliance with our insider trading policy.

14. Accounts Receivable

Financing Receivables

ASC 310, Receivables, requires disclosure regarding the credit quality of our financing receivables and allowance for credit losses including disclosure of credit quality indicators, past due information, and modifications of our financing receivables. Our financing receivables of \$30.7 and \$31.0 million consisted of \$17.6 and \$17.8 million of sales-type lease receivables, included within other current assets and other assets at September 30, 2017 and December 31, 2016, respectively, and \$13.1 and \$13.2 million of trade receivables having an original contractual maturity in excess of one year, included within accounts receivable, net of allowance, at September 30, 2017 and December 31, 2016, respectively. The trade receivables of \$13.1 and \$13.2 million having an original total contractual maturity in excess of one year at September 30, 2017 and December 31, 2016, include \$5.7 and \$7.1 million, respectively, which are scheduled to be received in less than one year. The credit quality of financing receivables is evaluated on the same basis as trade receivables. We do not have material past due financing receivables.

Accounts Receivable Sales Arrangements

In accordance with ASC 860-20, Transfers and Servicing, trade receivables are derecognized from our Condensed Consolidated Balance Sheet when sold to third parties upon determining that such receivables are presumptively beyond the reach of creditors in a bankruptcy proceeding. Any recourse obligation is measured using market data from similar transactions and the servicing liability is determined based on the fair value that a third party would charge to service these receivables. These liabilities were determined to not be material at September 30, 2017 and December 31, 2016.

We have facilities in the U.S. and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables with recourse. Trade receivables sold with recourse are generally short-term receivables with payment due dates of less than 10 days from the date of sale, which are subject to a servicing obligation. Trade receivables sold under these facilities were \$5.9 and \$15.3 million during the three and nine months ended September 30, 2017, respectively, and \$19.8 million during the year ended December 31, 2016, which approximates the cash received.

We have facilities in Spain and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables without recourse. Trade receivables sold without recourse are generally short-term receivables with payment due dates of less than one year, which are secured by international letters of credit. Trade receivables sold under these facilities were \$2.1 and \$3.1 million during the three and nine months ended September 30, 2017, respectively, and \$3.5 million during the year ended December 31, 2016, which approximates the cash received.

We report collections from the sale of trade receivables to third parties as operating cash flows in the Condensed Consolidated Statements of Cash Flows.

15. Subsequent Events

Acquisition of Escada

On October 1, 2017, we acquired privately held Escada Innovations Limited, a private limited company incorporated in England and Wales which is headquartered in Hull, East Yorkshire, United Kingdom, and Escada Systems, Inc., a Delaware corporation headquartered in Decatur, Georgia (collectively, "Escada"), for approximately \$11.3 million in cash consideration, plus a potential future cash earnout of \$4.8 million contingent on achieving certain performance targets. This acquisition will be accounted for as a purchase business combination and, accordingly, the total purchase price will be allocated to the tangible and intangible assets acquired and liabilities assumed based on their respective fair values on October 1, 2017.

Escada provides corrugator control systems for the corrugated packaging market, which provides comprehensive control and traceability for the entire corrugation process. Escada will be integrated into the Productivity Software operating segment.

Xeikon Agreement

On November 1, 2017 (“Effective Date”), we entered into a Support Services and License Agreement (“Agreement”) with Xeikon, N.V. (“Xeikon”), which is a division of the Flint Group headquartered in Luxembourg. Pursuant to the Agreement, we will provide Xeikon access to the Jetrion customer list. Access to the customer list will enable Xeikon to assume the relationship with the third-party outsourcing company that manufactures Jetrion printers for us and resell the printers to our current customer base. Xeikon will purchase Jetrion ink exclusively from us and resell to both our current customer base as well as new Xeikon inkjet customers. Also, we will cease sales of Jetrion products for four years after the Effective Date. We will receive cash consideration of \$2 million in the first year followed by three annual volume-based payments that are tied to Xeikon’s ink purchases from us.

Item 2: Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking Statements

This Quarterly Report on Form 10-Q (“Report”), including “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements regarding future events and the future results of the Company that are based on current expectations, estimates, forecasts, and projections about the industry in which the Company operates and the beliefs and assumptions of the management of the Company. Words such as “address,” “anticipate,” “believe,” “consider,” “continue,” “develop,” “estimate,” “expect,” “further,” “goal,” “intend,” “may,” “plan,” “potential,” “project,” “seek,” “should,” “target,” “will,” variations of such words, and similar expressions are intended to identify such forward-looking statements. Such statements reflect the current views of the Company and its management with respect to future events and are subject to certain risks, uncertainties, and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, the Company’s actual results, performance, or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Report under the section entitled “Risk Factors” in Item 1A of Part II of this report and Item 1A of Part I of our Annual Report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016 and elsewhere and in other reports the Company files with the SEC. The following discussion should be read in conjunction with our Annual Report on Form 10-K, as amended in Amendment No. 2, for the fiscal year ended December 31, 2016 and the condensed consolidated financial statements and notes thereto included elsewhere in this Report. The Company assumes no obligation to revise or update these forward-looking statements to reflect actual results, events, or changes in factors or assumptions affecting such forward-looking statements

Business Overview

We are a world leader in customer-centric digital printing innovation focused on the transformation of the printing, packaging, ceramic tile decoration, and textile industries from the use of traditional analog based printing to digital on-demand printing.

Our products include industrial super-wide and wide format display graphics, label and packaging, corrugated packaging, textile, and ceramic tile decoration digital inkjet printers that utilize our digital ink, industrial digital inkjet printer parts, and professional services; print production workflow, web-to-print, cross-media marketing, fashion design, and business process automation solutions; and color printing DFEs creating an on-demand digital printing ecosystem. Our ink includes digital UV curable, LED curable, ceramic, water-based, and thermoforming ink, as well as a variety of textile ink including dye sublimation, pigmented, reactive dye, acid dye, pure disperse dye, and water-based dispersed printing ink. Our award-winning business process automation solutions are integrated from creation to print and are vertically integrated with our industrial digital inkjet printers and products produced by the leading production digital color page printer manufacturers that are driven by our Fiery DFEs.

Our product portfolio includes industrial super-wide and wide format digital inkjet products (“Industrial Inkjet”) including VUTEk and Matan display graphics super-wide and wide format, Reggiani textile, Jetrion label and packaging, Nozomi corrugated packaging, and Cretaprint ceramic tile decoration and construction material industrial digital inkjet printers and ink; print production workflow, web-to-print, cross-media marketing, Optitex textile two-dimensional (“2D”) and three-dimensional (“3D”) fashion CAD applications, and business process automation software (“Productivity Software”), which provides corporate printing, label and packaging, publishing, and mailing and fulfillment solutions for the printing and packaging industry; and Fiery DFEs (“Fiery”). Our integrated solutions and award-winning technologies are designed to automate print and business processes, streamline workflow, provide profitable value-added services, and produce accurate digital output.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments, assumptions, and estimates that affect the amounts reported. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably possible could materially impact the financial statements. Management believes there have been no significant changes during the nine months ended September 30, 2017 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016, with the exception of the following:

Bill and Hold Transactions

We recognize revenue related to certain industrial inkjet printer sales under bill and hold arrangements. For any bill and hold arrangement, judgment is required to evaluate whether the sale qualifies for revenue recognition in accordance with the following criteria and factors requiring consideration:

- The customer requests that the transaction be on a bill and hold basis and has a substantial business purpose for the arrangement. Such business purpose is related to customer site readiness.
- The scheduled delivery date must be reasonable and consistent with the customer's business purpose (e.g., customary in the industry).
- The customer has made a fixed commitment to purchase the printer in written documentation.
- The printer is segregated from our inventory and is not available to fill any other customer orders.
- The risk of ownership has passed to the customer.
- The customer has the risk of loss in the event of loss, destruction, or a decline in the market value of goods.
- The printer is complete and ready for shipment.
- The date is determined by which we expect payment and we have not modified our normal billing and credit terms for the customer.
- Evaluation of our past experience with bill and hold transactions.
- We have not retained any specific performance obligations indicating the earnings process is not complete.
- Whether our custodial risks are insurable and insured.
- Extended procedures are not necessary to assure that there are no exceptions to the customer's commitment to accept and pay for the printer.

Recent Accounting Pronouncements

See Note 1 of our Notes to Condensed Consolidated Financial Statements for a full description of recent accounting pronouncements including the respective expected dates of adoption.

Overview

As discussed more fully in Note 1 – Basis of Presentation and Significant Accounting Policies of our Notes to Condensed Consolidated Financial Statements, during the nine months ended September 30, 2017, we recorded out-of-period adjustments related to certain bill and hold transactions, which decreased revenue by \$3.4 million, decreased gross profit by \$0.5 million, and decreased net income by \$0.3 million (or \$0.01 per diluted share).

Key financial results during the three and nine months ended September 30, 2017 were as follows:

- Our results of operations during the three and nine months ended September 30, 2017 compared with the three and nine months ended September 30, 2016 reflect increased revenue for the three months and comparable revenue for the nine months ended September 30, 2017, comparable gross profit as a percentage of revenue, and increased operating expenses as a percentage of revenue. We completed our acquisitions of GD, CRC, and FFPS in 2017, and of Rialco and Optitex in 2016. Their results are included in our results of operations commencing on their respective acquisition dates. Acquisition-related transaction costs were \$1.8 and \$1.7 million during the nine months ended September 30, 2017 and 2016, respectively, related to all acquisitions.
- Our consolidated revenue increased by 1%, or \$2.8 million during the three months ended September 30, 2017, compared with the three months ended September 30, 2016. Fiery revenue increased by \$5.4 million, which was partially offset by decreased Productivity Software revenue of \$2.5 million during the three months ended September 30, 2017, compared with the three months ended September 30, 2016.
- Our consolidated revenue during the nine months ended September 30, 2017, was comparable to the nine months ended September 30, 2016. Industrial Inkjet and Fiery revenue decreased by \$1.0 and \$3.0 million, respectively, while Productivity Software revenue increased by \$2.7 million during the nine months ended September 30, 2017, as compared with the same period in the prior year.
- Recurring ink and maintenance revenue increased by 5% and 8% during the three and nine months ended September 30, 2017, respectively, compared with the same periods in the prior year, and represented 34% of consolidated revenue during the three and nine months ended September 30, 2017.
- Our gross profit percentage was comparable at 51% during the three months and increased to 52% during the nine months ended September 30, 2017, respectively, from 51% during the nine months ended September 30, 2016. The gross profit percentage during the three months ended September 30, 2017 reflected a two percentage point increase in the Industrial Inkjet operating segment, partially offset by a four and two percentage point decrease in the Productivity Software and Fiery operating segment gross profit percentages, respectively. The increase in the gross profit percentage during the nine months ended September 30, 2017 was primarily due to a three percentage point increase in the Industrial Inkjet operating segment gross profit percentage. The improved Industrial Inkjet gross profit percentage during the nine months ended September 30, 2017 was due to improvements in manufacturing efficiency, reduced warranty costs due to improved printer quality, and higher margin ink revenue representing an increased percentage of product mix.
- Operating expenses increased by \$4.3 million to \$120.1 million and by \$14.2 million to \$354.7 million during the three and nine months ended September 30, 2017, respectively, from \$115.8 and \$340.6 million during the three and nine months ended September 30, 2016, respectively. The increase in operating expenses was primarily due to head count increases related to our business acquisitions, FFPS sustaining engineering, prototype and non-recurring engineering expenses related to future product launches, amortization of intangible assets, and legal and accounting revenue recognition review and assessment, partially offset by decreased change in the fair value of contingent consideration, trade show and marketing, stock-based compensation, and restructuring and other expenses.
- Interest expense increased by \$0.4 and \$1.3 million during the three and nine months ended September 30, 2017, respectively, compared with the three and nine months ended September 30, 2016, respectively, primarily due to interest accretion related to the FFPS purchase liability, the Reggiani non-compete agreement liability, and our Notes.
- Interest income and other income, net, increased to \$1.8 and \$2.8 million during the three and nine months ended September 30, 2017, respectively, from \$0.9 and \$1.1 million during the three and nine months ended September 30, 2016, respectively, primarily due to increased investment income and decreased foreign currency exchange losses.
- We recognized tax provisions of \$0.8 million on pre-tax net income of \$4.2 and \$11.8 million during the three and nine months ended September 30, 2017, respectively, compared to tax benefits of \$11.8 and \$9.0 million on pre-tax net income of \$5.8 and \$16.0 million during the three and nine months ended September 30, 2016, respectively. The decrease in the income tax provisions are primarily due to decreased tax benefits from a significantly lower reversal of uncertain tax positions in 2017 as compared to the amounts reversed in 2016.

Results of Operations

Our Condensed Consolidated Statements of Operations as a percentage of total revenue during the three and nine months ended September 30, 2017 and 2016 is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenue	100%	100%	100%	100%
Gross profit	51	51	52	51
Operating expenses:				
Research and development	16	15	16	15
Sales and marketing	17	17	18	18
General and administrative	10	10	9	9
Restructuring and other	—	1	1	1
Amortization of identified intangibles	5	4	5	4
Total operating expenses	48	47	49	47
Income from operations	3	4	3	4
Interest expense	(2)	(2)	(2)	(2)
Interest income and other income, net	1	—	1	—
Income before income taxes	2	2	2	2
Benefit from (provisions for) income taxes	(1)	5	—	1
Net income	1%	7%	2%	3%

Revenue

We classify our revenue, gross profit, assets, and liabilities in accordance with our three operating segments as follows:

“Industrial Inkjet,” which consists of our VUTEk and Matan super-wide and wide format display graphics, Reggiani textile, Jetrion label and packaging, Nozomi corrugated packaging, and Cretaprint ceramic tile decoration and construction material industrial digital inkjet printers; digital UV curable, LED curable, ceramic, water-based, and thermoforming ink, as well as a variety of textile ink including dye sublimation, pigmented, reactive dye, acid dye, pure disperse dye, and water-based dispersed printing ink; digital inkjet printer parts; and professional services. Printing surfaces include paper, vinyl, corrugated, textile, glass, plastic, aluminum composite, ceramic tile, wood, and many other flexible and rigid substrates.

“Productivity Software,” which consists of a complete software suite that enables efficient and automated end-to-end business and production workflows for the print and packaging industry. This *Productivity Suite* also provides tools to enable revenue growth, efficient scheduling, and optimization of processes, equipment, and personnel. Customers are provided the financial and technical flexibility to deploy locally within their business or to be hosted in the cloud. The Productivity Suite addresses all segments of the print industry and consists of the: (i) *Packaging Suite*, with Radius at its core, for tag & label, cartons, and flexible packaging businesses; (ii) *Corrugated Packaging Suite*, with CTI at its core, for corrugated packaging businesses; (iii) *Enterprise Commercial Print Suite*, with Monarch at its core, for enterprise print businesses; (iv) *Publication Print Suite*, with Monarch or Technique at its core, for publication print businesses; (v) *Midmarket Print Suite*, with Pace at its core, for medium size print businesses; (vi) *Quick Print Suite*, with PrintSmith at its core, for small printers and in-plant sites; and (vii) *Value Added Products*, available with the suite and standalone, such as web-to-print, e-commerce, cross media marketing, warehousing, fulfillment, shop floor data collection, and shipping to reduce costs, increase profits, and offer new products and services to their existing and future customers. We also market Optitex fashion CAD software, which facilitates fast fashion and increased efficiency in the textile and fashion industries.

“Fiery,” which consists of DFEs, including the recently acquired FFPS DFE from Xerox, that transform digital copiers and printers into high performance networked printing devices for the office, industrial, and commercial printing markets. This operating segment is comprised of (i) stand-alone DFEs connected to digital printers, copiers, and other peripheral devices, (ii) embedded DFEs and design-licensed solutions used in digital copiers and multi-functional devices, (iii) optional software integrated into our DFE solutions such as Fiery Central, Generation Digital, and Graphics Arts Package, (iv) Fiery Self Serve, our self-service and payment solution, and (v) stand-alone software-based solutions such as our proofing solutions.

[Table of Contents](#)

Ex-Currency. To better understand trends in our business, we believe it is helpful to adjust our Condensed Consolidated Statements of Operations to exclude the impact of year-over-year changes in the translation of foreign currencies into U.S. dollars. This is a non-GAAP measure that is calculated by adjusting revenue, gross profit, and operating expenses by using historical exchange rates in effect during the comparable prior period and removing the balance sheet currency remeasurement impact from interest income and other income, net, including removal of any hedging gains and losses. We refer to these adjustments as “ex-currency.” The year-over-year currency impact can be determined as the difference between year-over-year actual growth rates and year-over-year ex-currency growth rates.

Management believes the ex-currency measures provide investors with an additional perspective on year-over-year financial trends and enables investors to analyze our operating results in the same way management does. A reconciliation of the ex-currency adjustments to GAAP results for the three and nine months ended September 30, 2017 and 2016 and an explanation of how management uses non-GAAP financial information to evaluate its business, the substance behind management’s decision to use this non-GAAP financial information, the material limitations associated with the use of non-GAAP financial information, the manner in which management compensates for those limitations, and the substantive reasons management believes that this non-GAAP financial information provides useful information to investors is included under “Non-GAAP Financial Information” below.

Revenue by Operating Segment during the Three Months Ended September 30, 2017 and 2016

Our revenue by operating segment during the three months ended September 30, 2017 and 2016 was as follows (in thousands):

	Three months ended September 30,					
	2017	Percent of total	2016	Percent of total	Change	
					\$	%
Industrial Inkjet	\$ 142,930	58%	\$ 143,004	58%	\$ (74)	— %
Productivity Software	37,171	15	39,663	16	(2,492)	(6)
Fiery	68,258	27	62,908	26	5,350	9
Total revenue	<u>\$248,359</u>	<u>100%</u>	<u>\$245,575</u>	<u>100%</u>	<u>\$ 2,784</u>	<u>1%</u>

Overview

Our consolidated revenue increased by 1% (zero percent ex-currency), or \$2.8 million, to \$248.4 million during the three months ended September 30, 2017 from \$245.6 million for the three months ended September 30, 2016, primarily due to increased Fiery revenue, partially offset by decreased Productivity Software revenue.

Industrial Inkjet

Industrial Inkjet revenue decreased by less than 1% (2% ex-currency) during the three months ended September 30, 2017 compared with the three months ended September 30, 2016. Industrial Inkjet revenue decreased primarily due to:

- decreased digital inkjet printer revenue due to reduced demand, partially offset by
- increased ink revenue due to the increase in our installed printer base and the high utilization that our industrial digital inkjet printers are experiencing in the field, and
- increased revenue from parts and service.

Productivity Software

Productivity Software revenue decreased by 6% (7% ex-currency) during the three months ended September 30, 2017 compared with the three months ended September 30, 2016 primarily due to decreased license revenue, partially offset by post-acquisition CRC revenue, which was acquired in May 2017, and increased maintenance revenue, which was partially due to annual price increases related to our maintenance contracts.

[Table of Contents](#)**Fiery**

Fiery revenue increased by 9% (8% ex-currency) during the three months ended September 30, 2017 compared with the three months ended September 30, 2016. Although end customer and reseller preference for Fiery products drives demand, most Fiery revenue relies on printer manufacturers to design, develop, and integrate Fiery technology into their print engines. The leading printer manufacturers increased demand during the quarter as they increased their inventory levels. Also contributing to the increase was post-acquisition FFPS revenue, which was acquired in January 2017, and a small amount of post-acquisition GD revenue, which was acquired in August 2017.

Revenue by Operating Segment during the Nine Months Ended September 30, 2017 and 2016

Our revenue by operating segment during the nine months ended September 30, 2017 and 2016 was as follows (in thousands):

	Nine months ended September 30,					
	2017	Percent of total	2016	Percent of total	Change	
					\$	%
Industrial Inkjet	\$407,886	56%	\$408,926	56%	\$(1,040)	— %
Productivity Software	111,292	16	108,554	15	2,738	3
Fiery	204,919	28	207,878	29	(2,959)	(1)
Total revenue	<u>\$724,097</u>	<u>100%</u>	<u>\$725,358</u>	<u>100%</u>	<u>\$(1,261)</u>	<u>— %</u>

Overview

Our consolidated revenue decreased by less than 1% (zero percent ex-currency), or \$1.3 million, to \$724.1 million during the nine months ended September 30, 2017 from \$725.4 million for the nine months ended September 30, 2016, primarily due to decreased Industrial Inkjet and Fiery revenue, partially offset by increased Productivity Software revenue.

Industrial Inkjet

Industrial Inkjet revenue decreased by less than 1% (zero percent ex-currency) during the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016. Industrial Inkjet revenue decreased primarily due to:

- decreased digital inkjet printer revenue due to reduced demand and
- printer revenue, which would have been higher by \$3.4 million when considering out-of-period adjustments related to certain bill and hold transactions, which were recorded during the nine months ended September 30, 2017, partially offset by
- a full nine months of post-acquisition Rialco ink products revenue, which closed in March 2016,
- increased ink revenue due to the increase in our installed printer base and the high utilization that our industrial digital inkjet printers are experiencing in the field, and
- increased revenue from parts and service.

Productivity Software

Productivity Software revenue increased by 3% (also 3% ex-currency) during the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016 primarily due to post-acquisition Optitex revenue, which was acquired in June 2016, post-acquisition CRC revenue, which was acquired in May 2017, increased service revenue, and annual price increases related to our maintenance contracts, partially offset by decreased license revenue.

Fiery

Fiery revenue decreased by 1% (also 1% ex-currency) during the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016. Although end customer and reseller preference for Fiery products drives demand, most Fiery revenue relies on printer manufacturers to design, develop, and integrate Fiery technology into their print engines. The leading printer manufacturers tightly managed their inventory levels in the first half of 2017, which decreased demand, which was partially offset by increased inventory levels and increased demand during the three months ended September 30, 2017. This decrease was partially offset by post-acquisition FFPS revenue, which was acquired in January 2017, and a small amount of GD revenue, which was acquired in August 2017.

[Table of Contents](#)Revenue by Geographic Area during the Three Months Ended September 30, 2017 and 2016

Shipments to some of our significant printer manufacturer customers are made to centralized purchasing and manufacturing locations, which in turn ship to other locations, making it difficult to obtain accurate geographical shipment data. Accordingly, we believe that export sales of our products into each region may differ from what is reported.

Our revenue by geographic area during the three months ended September 30, 2017 and 2016 was as follows (in thousands):

	Three months ended September 30,					
	2017	Percent of total	2016	Percent of total	Change	
					\$	%
Americas	\$ 129,488	52%	\$ 128,252	52%	\$ 1,236	1%
EMEA	85,089	34	85,009	35	80	0
APAC	33,782	14	32,314	13	1,468	5
Total revenue	<u>\$248,359</u>	<u>100%</u>	<u>\$245,575</u>	<u>100%</u>	<u>\$2,784</u>	<u>1%</u>

Overview

Our consolidated revenue increased by 1% (zero percent ex-currency), or \$2.8 million, to \$248.4 million during the three months ended September 30, 2017 from \$245.6 million during the three months ended September 30, 2016, primarily due to increased Americas and APAC revenue.

Americas

Americas revenue increased by \$1.2 million, or 1% (also 1% ex-currency), during the three months ended September 30, 2017 compared with the three months ended September 30, 2016 due to increased industrial digital inkjet printer and maintenance revenue, partially offset by decreased license and Fiery revenue.

EMEA

EMEA revenue increased by \$0.1 million, or less than 1% (decreased by 3% ex-currency), during the three months ended September 30, 2017 compared with the three months ended September 30, 2016 primarily due to increased Fiery revenue, partially offset by decreased industrial digital inkjet printer revenue.

APAC

APAC revenue increased by \$1.5 million, or 5% (3% ex-currency), during the three months ended September 30, 2017 compared with the three months ended September 30, 2016 primarily due to increased industrial digital inkjet printer and Fiery revenue, partially offset by decreased license revenue.

Revenue by Geographic Area during the Nine Months Ended September 30, 2017 and 2016

Our revenue by geographic area during the nine months ended September 30, 2017 and 2016 was as follows (in thousands):

	Nine months ended September 30,					
	2017	Percent of total	2016	Percent of total	Change	
					\$	%
Americas	\$ 353,397	49%	\$ 363,977	50%	\$ (10,580)	(3)%
EMEA	274,635	38	264,469	37	10,166	4
APAC	96,065	13	96,912	13	(847)	(1)
Total revenue	<u>\$ 724,097</u>	<u>100%</u>	<u>\$ 725,358</u>	<u>100%</u>	<u>\$ (1,261)</u>	<u>(0)%</u>

Overview

Our consolidated revenue decreased by less than 1% (zero percent ex-currency), or \$1.3 million, to \$724.1 million during the nine months ended September 30, 2017 from \$725.4 million during the nine months ended September 30, 2016, primarily due to decreased Americas and APAC revenue, partially offset by increased EMEA revenue.

[Table of Contents](#)**Americas**

Americas revenue decreased by \$10.6 million, or 3% (also 3% ex-currency), during the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016 primarily due to decreased industrial digital inkjet printer revenue due to reduced demand in anticipation of future product launches, decreased Fiery revenue, and that industrial digital inkjet revenue would have been higher by \$3.4 million when considering out-of-period adjustments related to certain bill and hold transactions, partially offset by increased ink and Productivity Software revenue. Increased Productivity Software revenue resulted primarily from our acquisition of Optitex in June 2016, and our acquisition of CRC in May 2017, partially offset by decreased license revenue.

EMEA

EMEA revenue increased by \$10.2 million, or 4% (5% ex-currency), during the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016 primarily due to increased industrial digital inkjet printer, post-acquisition Optitex, and Fiery revenue, partially offset by decreased license revenue.

APAC

APAC revenue decreased by \$0.8 million, or 1% (also 1% ex-currency), during the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016 primarily due to decreased industrial digital inkjet printer revenue, partially offset by post-acquisition Optitex revenue and Fiery revenue.

Revenue Concentration

A substantial portion of our revenue over the years has been attributable to sales of products through the leading printer manufacturers and independent distributor channels. We have a direct relationship with several leading printer manufacturers and work closely to design, develop, and integrate Fiery technology into their print engines. The printer manufacturers act as distributors and sell our DFE products to end customers through reseller channels. End customer and reseller channel preference for our DFE and software solutions drive demand for Fiery products through the printer manufacturers.

Although end customer and reseller channel preference for Fiery products drives demand, most Fiery revenue relies on printer manufacturers to design, develop, and integrate Fiery technology into their print engines. A significant portion of our revenue is, and has been, generated by sales of our Fiery DFE products to a relatively small number of leading printer manufacturers. During the three and nine months ended September 30, 2017, Xerox provided 11% and 10% of our consolidated revenue, respectively. During the three and nine months ended September 30, 2016, we did not have any customers contributing more than 10% of our consolidated revenue. We expect that if we increase our revenue in the Industrial Inkjet and Productivity Software operating segments in the future, the percentage of our revenue from the leading printer manufacturer customers will decrease.

Gross Profit

Gross profit by operating segment, excluding stock-based compensation, during the three and nine months ended September 30, 2017 and 2016 was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Industrial Inkjet				
Revenue	\$ 142,930	\$ 143,004	\$ 407,886	\$ 408,926
Gross profit	53,392	50,433	154,972	141,927
Gross profit percentages	37.4%	35.3%	38.0%	34.7%
Productivity Software				
Revenue	\$ 37,171	\$ 39,663	\$ 111,292	\$ 108,554
Gross profit	26,667	30,041	81,431	80,961
Gross profit percentages	71.7%	75.7%	73.2%	74.6%
Fiery				
Revenue	\$ 68,258	\$ 62,908	\$ 204,919	\$ 207,878
Gross profit	47,885	45,362	143,821	147,938
Gross profit percentages	70.2%	72.1%	70.2%	71.2%

[Table of Contents](#)

A reconciliation of our segment gross profit to our Condensed Consolidated Statements of Operations during the three and nine months ended September 30, 2017 and 2016 was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Segment gross profit	\$ 127,944	\$ 125,836	\$ 380,224	\$ 370,826
Stock-based compensation expense	(486)	(642)	(1,985)	(1,873)
Other items excluded from segment profit	—	—	—	(315)
Gross profit	<u>\$ 127,458</u>	<u>\$ 125,194</u>	<u>\$ 378,239</u>	<u>\$ 368,638</u>

The Fiery gross profit percentage is impacted by less than \$0.1 and \$1.3 million during the three and nine months ended September 30, 2017, respectively, charged to cost of revenue, which reflects the cost of manufacturing plus a portion of the expected profit margin related to the acquired FFPS inventories. Inventory acquired in the acquisition of FFPS was required to be recorded at fair value rather than historical cost in accordance with ASC 805. This amount is not included in the financial information regularly reviewed by management as this acquisition-related charge is not indicative of the gross margin trends in the FFPS business. Excluding this charge, the Fiery gross profit percentage would be 70.3% and 70.8% during the three and nine months ended September 30, 2017, respectively.

Overview

Our gross profit percentage was comparable at 51% during the three months and increased to 52% during the nine months ended September 30, 2017, respectively, from 51% during the nine months ended September 30, 2016. The gross profit percentage during the three months ended September 30, 2017 reflected a two percentage point improvement in the Industrial Inkjet operating segment, partially offset by a four and two percentage point decrease in the Productivity Software and Fiery operating segment gross profit percentages, respectively. The increase in the gross profit percentage during the nine months ended September 30, 2017 was primarily due to a three percentage point increase in the Industrial Inkjet operating segment gross profit percentage. Excluding FFPS acquisition-related inventory fair value adjustments of less than \$0.1 and \$1.3 million for the three and nine months ended September 30, 2017, respectively, our gross profit percentage remains at 51% and 52% during the three and nine months ended September 30, 2017, respectively.

Industrial Inkjet Gross Profit

The Industrial Inkjet gross profit percentage increased to 37.4% and 38.0% (37.0% ex-currency and 38.0% ex-currency) during the three and nine months ended September 30, 2017, respectively, from 35.3% and 34.7% during the three and nine months ended September 30, 2016, respectively. Gross profit percentages improved in digital inkjet printers, ink, parts, and service.

Productivity Software Gross Profit

The Productivity Software gross profit percentages decreased to 71.7% and 73.2% (71.7% and 73.0% ex-currency) during the three and nine months ended September 30, 2017, from 75.7% and 74.6% during the three and nine months ended September 30, 2016, respectively. The decrease was primarily due to decreased license revenue and increased product maintenance costs, partially offset by price increases on annual maintenance renewal contracts.

Fiery Gross Profit

The Fiery gross profit percentage decreased to 70.2% (also 70.2% ex-currency) during the three and nine months ended September 30, 2017 from 72.1% and 71.2% during the three and nine months ended September 30, 2016, respectively. The Fiery gross profit percentage, excluding the fair value adjustment related to acquired FFPS inventories of less than \$0.1 and \$1.3 million, respectively, decreased to 70.3% and 70.8% (also 70.3% and 70.8% ex-currency) during the three and nine months ended September 30, 2017 from 72.1% and 71.2% during the three and nine months ended September 30, 2016, respectively. The revenue mix between standalone and embedded DFEs, which have a lower margin compared with higher margin software options, accounts for this margin fluctuation between the periods.

[Table of Contents](#)*Operating Expenses*

Operating expenses during the three and nine months ended September 30, 2017 and 2016 were as follows (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Research and development	\$ 39,585	\$ 36,933	\$ 2,652	7%	\$ 118,201	\$ 111,731	\$ 6,470	6%
Sales and marketing	42,269	43,060	(791)	(2)	129,018	127,360	1,658	1
General and administrative	25,075	24,088	987	4	67,239	66,366	873	1
Restructuring and other	833	1,308	(475)	(36)	5,421	5,733	(311)	(5)
Amortization of identified intangibles	12,299	10,395	1,904	18	34,829	29,360	5,469	19
Total operating expenses	<u>\$ 120,061</u>	<u>\$ 115,784</u>	<u>\$ 4,277</u>	<u>4%</u>	<u>\$ 354,708</u>	<u>\$ 340,550</u>	<u>\$ 14,158</u>	<u>4%</u>

Operating expenses increased by \$4.3 and \$14.2 million, or 4% (2% and 4% ex-currency) to \$120.1 and \$354.7 million during the three and nine months ended September 30, 2017, respectively, from \$115.8 and \$340.6 million during the three and nine months ended September 30, 2016, respectively. The increase in operating expenses was primarily due to head count increases related to our business acquisitions, prototype and non-recurring engineering expenses related to future product launches and FFPS sustaining engineering, amortization of intangible assets, and legal and accounting fees related to the revenue recognition review and assessment, partially offset by decreased stock-based compensation expense, change in the fair value of contingent consideration, and restructuring and other expenses.

Research and Development

Research and development expenses include personnel, consulting, travel, research and development facilities, prototype materials, and non-recurring engineering expenses.

Research and development expenses during the three months ended September 30, 2017 were \$39.6 million, or 16% of revenue, compared to \$36.9 million, or 15% of revenue, during the three months ended September 30, 2016, which is an increase of \$2.7 million, or 7% (6% ex-currency). Personnel-related expenses decreased by \$0.3 million primarily due to reduced head count. Prototypes and non-recurring engineering, consulting, contractors, supplies, freight, and related travel expenses increased by \$2.0 million related to future product launches and FFPS sustaining engineering. Stock-based compensation expense decreased by \$0.4 million primarily due to decreased RSU grants and vesting probabilities of certain performance based awards, partially offset by increased ESPP participation by employees compared to the prior year. Facilities expenses related to our research and development activities increased by \$1.3 million.

Research and development expenses during the nine months ended September 30, 2017 were \$118.2 million, or 16% of revenue, compared to \$111.7 million, or 15% of revenue, during the nine months ended September 30, 2016, which is an increase of \$6.5 million, or 6% (5% ex-currency). Personnel-related expenses decreased by \$0.7 million primarily due to reduced head count. Prototypes and non-recurring engineering, consulting, contractors, supplies, freight, and related travel expenses increased by \$5.7 million related to future product launches and FFPS sustaining engineering. Stock-based compensation expense increased by \$0.6 million primarily due to increased ESPP participation by employees compared to the prior year, partially offset by decreased RSU grants and vesting probabilities of certain performance based awards. Facilities expenses related to our research and development activities increased by \$0.9 million.

We expect that if the U.S. dollar remains volatile against the Indian rupee, Euro, British pound sterling, Israeli shekel, Canadian dollar or Brazilian real, research and development expenses reported in U.S. dollars could fluctuate, although we hedge our operating expense exposure to the Indian rupee, which partially mitigates this risk.

Sales and Marketing

Sales and marketing expenses include personnel, trade shows, marketing programs and promotional materials, sales commissions, travel and entertainment, depreciation, and worldwide sales office expenses.

[Table of Contents](#)

Sales and marketing expenses during the three months ended September 30, 2017 were \$42.3 million, or 17% of revenue, compared to \$43.1 million, or 17% of revenue, during the three months ended September 30, 2016, which is a decrease of \$0.8 million, or 2% (3% ex-currency). Personnel-related expenses increased by \$1.2 million primarily due to increased head count related to our business acquisitions. Trade show and marketing program spending, including consulting, contractor, travel, and freight, decreased by \$1.1 million. Stock-based compensation expense decreased by \$1.2 million primarily due to decreased RSU grants and vesting probabilities of certain performance based awards, partially offset by increased ESPP participation by employees compared to the prior year. Facilities and information technology expenses related to our sales and marketing activities increased by \$0.3 million.

Sales and marketing expenses during the nine months ended September 30, 2017 were \$129.0 million, or 18% of revenue, compared to \$127.4 million, or 18% of revenue, during the nine months ended September 30, 2016, which is an increase of \$1.7 million, or 1% (2% ex-currency). Personnel-related expenses increased by \$3.7 million primarily due to increased head count related to our business acquisitions. Trade show and marketing program spending, including consulting, contractor, travel, and freight, decreased by \$2.2 million as the prior year included Drupa trade show costs. Drupa is an international printing trade show that is held every four years. Stock-based compensation expense decreased by \$1.0 million primarily due to decreased RSU grants and vesting probabilities of certain performance based awards, partially offset by increased ESPP participation by employees compared to the prior year. Facilities and information technology expenses related to our sales and marketing activities increased by \$1.2 million.

Over time, our sales and marketing expenses may increase in absolute terms if revenue increases in future periods, as we continue to actively promote our products and introduce new services and products. We expect that if the U.S. dollar remains volatile against the Euro, British pound sterling, Brazilian real, Israeli shekel, Australian dollar, and other currencies, sales and marketing expenses reported in U.S. dollars could fluctuate.

General and Administrative

General and administrative expenses consist primarily of human resources, legal, and finance expenses.

General and administrative expenses during the three months ended September 30, 2017 were \$25.1 million, or 10% of revenue, compared to \$24.1 million, or 10% of revenue, during the three months ended September 30, 2016, which is an increase of \$1.0 million, or 4% (3% ex-currency). Personnel-related expenses increased by \$0.9 million primarily due to head count increases related to our business acquisitions. Reserves for litigation and doubtful accounts increased by \$0.8 million. Legal and accounting fees related to the revenue recognition review and assessment were \$4.7 million. Other legal fees increased by \$0.5 million. Stock-based compensation expense decreased by \$2.2 million primarily due to decreased RSU grants and vesting probabilities of certain performance based awards.

The fair value of contingent consideration increased by \$0.4 million, including earnout interest accretion related to all acquisitions during the three months ended September 30, 2017. The Optitex earnout performance probability increased while the Shuttleworth earnout performance probability decreased during 2017. The estimated probability of achieving the Optitex, Reggiani, DirectSmile, and CTI earnout performance targets increased during the three months ended September 30, 2016, which resulted in an increase in the associated liability and a charge to general and administrative expense of \$4.3 million, including accretion of interest related to all acquisitions.

General and administrative expenses during the nine months ended September 30, 2017 were \$67.2 million, or 9% of revenue, compared to \$66.4 million, or 9% of revenue, during the nine months ended September 30, 2016, which is an increase of \$0.9 million, or 1% (also 1% ex-currency). Personnel-related expenses increased by \$2.1 million primarily due to head count increases related to our business acquisitions. Professional services fees increased by \$0.7 million. Reserves for litigation and doubtful accounts increased by \$0.6 million. Legal and accounting fees related to the revenue recognition review and assessment were \$4.7 million. Other legal fees increased by \$0.4 million. Stock-based compensation expense decreased by \$4.1 million primarily due to decreased RSU grants and vesting probabilities of certain performance based awards. Facilities and information technology expenses related to general and administrative activities increased by \$0.6 million.

The fair value of contingent consideration increased by \$2.2 million, including earnout interest accretion related to all acquisitions during the nine months ended September 30, 2017. The Optitex and CTI earnout performance probabilities increased while the Shuttleworth earnout performance probability decreased during 2017. The estimated probability of achieving the Optitex, Reggiani, DirectSmile, and CTI earnout performance targets increased during the nine months ended September 30, 2016, partially offset by a reduced probability of achieving the DIMS earnout performance target, resulting in an increase in the associated liability and a charge to general and administrative expense of \$6.3 million, including accretion of interest related to all acquisitions.

[Table of Contents](#)

We expect that if the U.S. dollar remains volatile against the Euro, British pound sterling, Indian rupee, Israeli shekel, Brazilian real, or other currencies, general and administrative expenses reported in U.S. dollars could fluctuate.

Stock-based Compensation

We account for stock-based payment awards in accordance with ASC 718, which requires stock-based compensation expense to be recognized based on the fair value of such awards on the date of grant. We amortize compensation cost on a graded vesting basis over the vesting period, after assessing the probability of achieving requisite performance criteria with respect to performance-based and market-based awards. Stock-based compensation cost is recognized over the requisite service period for each separately vesting tranche of the award as though the award were, in substance, multiple awards. This results in greater stock-based compensation expense during the initial years of the vesting period.

Stock-based compensation expenses were \$4.6 and \$8.6 million during the three months ended September 30, 2017 and 2016, respectively, a decrease of \$4.0 million. Stock-based compensation expenses were \$22.5 and \$26.9 million during the nine months ended September 30, 2017 and 2016, respectively, a decrease of \$4.4 million. Stock-based compensation expense decreased primarily due to decreased RSU grants and vesting probabilities of certain performance based awards, partially offset by increased ESPP expense resulting from higher employee participation compared to the prior year. There were no RSU grants during the three months ended September 30, 2017, and reduced grants compared to the nine months ended September 30, 2017.

Restructuring and Other

Restructuring and other costs were \$0.8 and \$5.4 million during the three and nine months ended September 30, 2017, respectively, and \$1.3 and \$5.7 million during the three and nine months ended September 30, 2016, respectively. Restructuring and other costs include severance charges of \$0.3 and \$3.8 million related to reductions in head count of 15 and 128 during the three and nine months ended September 30, 2017, respectively, and \$0.6 and \$3.7 million related to reduction in head count of 16 and 114 during the three and nine months ended September 30, 2016, respectively. Severance costs include severance payments, related employee benefits, outplacement fees, and employee relocation costs.

Facilities relocation and downsizing expenses were \$0.4 and \$0.6 million during the nine months ended September 30, 2017, respectively, and \$0.1 and \$0.6 million during the three and nine months ended September 30, 2016, primarily related to the relocation of certain manufacturing and administrative locations due to reduced space requirements. Integration expenses of \$0.2 and \$1.0 million during the three and nine months ended September 30, 2017, respectively, and \$0.6 and \$1.5 million during the three and nine months ended September 30, 2016, respectively, were required to integrate our business acquisitions.

Amortization of Identified Intangibles

Amortization of identified intangibles during the three months ended September 30, 2017 was \$12.3 million, or 5% of revenue, compared to \$10.4 million, or 4% of revenue, during the three months ended September 30, 2016, an increase of \$1.9 million, or 18%. Amortization of identified intangibles during the nine months ended September 30, 2017 was \$34.8 million, or 5% of revenue, compared to \$29.4 million, or 4% of revenue, during the nine months ended September 30, 2016, an increase of \$5.5 million, or 19%. Intangible amortization increased primarily due to amortization of identified intangibles resulting from the GC, CRC, and FFPS acquisitions, partially offset by decreased amortization due to certain intangible assets from prior year acquisitions becoming fully amortized.

Interest Expense

Interest expense during the three and nine months ended September 30, 2017 was \$4.9 and \$14.5 million, respectively, compared to \$4.5 and \$13.2 million during the three and nine months ended September 30, 2016, respectively, an increase of \$0.4 and \$1.3 million primarily due to interest accretion related to the FFPS purchase liability, the Reggiani non-compete agreement liability, and our Notes.

Interest Income and Other Income, Net

Interest income and other income, net, includes interest income on our cash equivalents and short-term investments, gains and losses from sales of our cash equivalents and short-term investments, and net foreign currency exchange gains and losses.

[Table of Contents](#)

Interest income and other income, net, increased to \$1.8 and \$2.8 million during the three and nine months ended September 30, 2017, respectively, from \$0.9 and \$1.1 million during the three and nine months ended September 30, 2016, respectively, primarily due to increased investment income resulting from increased market interest rates and decreased foreign currency exchange losses.

Income Before Income Taxes

The components of income before income taxes during the three and nine months ended September 30, 2017 and 2016 are as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
U.S.	\$ (804)	\$ (210)	\$ (2,795)	\$ 7,247
Foreign	5,049	6,025	14,590	8,712
Total	<u>\$4,245</u>	<u>\$ 5,815</u>	<u>\$11,795</u>	<u>\$15,959</u>

During the three months ended September 30, 2017, pretax net income of \$4.2 million consisted of U.S. pretax net loss of \$0.8 million and foreign pretax net income of \$5.0 million, respectively. Pretax net loss attributable to U.S. operations included amortization of identified intangible assets of \$3.4 million, stock-based compensation of \$4.6 million, restructuring and other of \$0.7 million, acquisition-related costs of \$0.6 million, legal and accounting fees related to the revenue recognition review and assessment of \$4.7 million, and interest expense related to our Notes of \$4.3 million. Pretax net income attributable to foreign operations included amortization of identified intangible assets of \$8.9 million, restructuring and other of \$0.2 million, and earnout interest accretion of \$0.3 million. The exclusion of these items from pretax net income would result in U.S. and foreign pretax net income of \$17.5 and \$14.4 million, respectively, during the three months ended September 30, 2017.

During the nine months ended September 30, 2017, pretax net income of \$11.8 million consisted of U.S. pretax net loss of \$2.8 million and foreign pretax net income of \$14.6 million, respectively. Pretax net loss attributable to U.S. operations included amortization of identified intangible assets of \$10.2 million, stock-based compensation of \$22.5 million, restructuring and other of \$4.1 million, legal and accounting fees related to the revenue recognition review and assessment of \$4.7 million, acquisition-related costs of \$1.9 million, cost of revenue resulting from the fair value adjustment of FFPS inventory of \$0.5 million, change in fair value of contingent consideration of \$0.7 million, litigation settlement expense of \$0.3 million, and interest expense related to our Notes of \$12.7 million. Pretax net income attributable to foreign operations included amortization of identified intangible assets of \$24.7 million, restructuring and other of \$1.3 million, cost of revenue resulting from the fair value adjustment of FFPS inventory of \$0.7 million, earnout interest accretion of \$1.2 million, and change in fair value of contingent consideration of \$0.3 million. The exclusion of these items from pretax net income would result in U.S. and foreign pretax net income of \$54.8 and \$42.8 million, respectively, during the nine months ended September 30, 2017.

During the three months ended September 30, 2016, pretax net income of \$5.8 million consisted of U.S. pretax net loss of \$0.2 million and foreign pretax net income of \$6.0 million, respectively. Pretax net loss attributable to U.S. operations included amortization of identified intangibles of \$1.9 million, stock-based compensation of \$8.6 million, restructuring and other of \$0.9 million, acquisition-related costs of \$0.4 million, change in fair value of contingent consideration of \$0.5 million, and interest expense related to our Notes of \$4.2 million. Pretax net income attributable to foreign operations included amortization of identified intangibles of \$8.5 million, restructuring and other of \$0.4 million, and change in fair value of contingent consideration of \$3.8 million. The exclusion of these items from pretax net income would result in U.S. and foreign pretax net income of \$16.3 and \$18.7 million, respectively, during the three months ended September 30, 2016.

During the nine months ended September 30, 2016, pretax net income of \$16.0 million consisted of U.S. and foreign pretax net income of \$7.3 and \$8.7 million, respectively. Pretax net income attributable to U.S. operations included amortization of identified intangibles of \$5.8 million, stock-based compensation of \$26.9 million, restructuring and other of \$3.1 million, acquisition-related costs of \$1.4 million, litigation settlement expense of \$0.9 million, change in fair value of contingent consideration of \$0.5 million, and interest expense related to our Notes of \$12.2 million. Pretax net income attributable to foreign operations included amortization of identified intangibles of \$23.6 million, restructuring and other of \$2.6 million, acquisition-related costs of \$0.3 million, and change in fair value of contingent consideration of \$5.8 million. The exclusion of these items from pretax net income would result in U.S. and foreign pretax net income of \$58.1 and \$41.0 million, respectively, during the nine months ended September 30, 2016.

[Table of Contents](#)*Benefit from (provision) for Income Taxes*

We recognized tax provisions of \$0.8 million on pretax net income of \$4.2 and \$11.8 million during the three and nine months ended September 30, 2017, respectively. We recognized tax benefits of \$11.8 and \$9.0 million on pretax net income of \$5.8 and \$16.0 million during the three and nine months ended September 30, 2016, respectively. The provisions for income taxes before discrete items reflected in the table below were \$1.9 and \$4.5 million during the three and nine months ended September 30, 2017, respectively, and \$3.3 and \$6.1 million during the three and nine months ended September 30, 2016, respectively. The decrease in the provisions for income taxes before discrete items during the three and nine months ended September 30, 2017, compared with the same periods in the prior year, is primarily due to decreased profitability before income taxes.

Primary differences between our provision for income taxes before discrete items and the income tax provision at the U.S. statutory rate of 35% include lower taxes on permanently reinvested foreign earnings, the tax effects of stock-based compensation expense pursuant to ASC 718-740, Stock Compensation – Income Taxes, which are non-deductible for tax purposes, and tax benefits from significantly lower reversal of uncertain tax positions in 2017 as compared to those recorded in 2016.

Our tax provision before discrete items is reconciled to our recorded benefit from income taxes during the three and nine months ended September 30, 2017 and 2016 as follows (in millions):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Provision for income taxes before discrete items	\$ 1.9	\$ 3.3	\$ 4.5	\$ 6.1
Interest related to unrecognized tax benefits	—	—	0.1	0.3
Reassessment of taxes upon filing tax returns	0.3	(0.2)	0.4	(0.2)
Provision (benefit) related to stock based compensation, including ESPP dispositions	0.4	(1.4)	(1.9)	(1.7)
Benefit from reassessment of taxes upon foreign statutory tax rate change	—	—	(0.5)	—
Benefit from reversals of uncertain tax positions due to statute of limitation expirations	(1.8)	(13.5)	(1.8)	(13.5)
Benefit from income taxes	<u>\$ 0.8</u>	<u>\$ (11.8)</u>	<u>\$ 0.8</u>	<u>\$ (9.0)</u>

We earn a significant amount of our operating income outside the U.S., which is deemed to be permanently reinvested in foreign jurisdictions. Of the income generated in jurisdictions with tax rates materially lower than the statutory U.S. tax rate of 35%, most is earned in the Netherlands, Spain, United Kingdom, Italy, and the Cayman Islands. Our effective tax rate could fluctuate significantly and be adversely impacted if anticipated earnings in the Netherlands, Spain, and the Cayman Islands are proportionally lower than current projections and earnings in all other jurisdictions are proportionally higher than current projections.

While we currently do not foresee a need to repatriate the earnings of foreign operations, should we require more capital in the U.S. than is generated by our U.S. operations, we may elect to repatriate funds held in our foreign jurisdictions or raise capital in the U.S. through debt or equity issuances. These alternatives could result in higher effective tax rates, the cash payments of taxes and/or increased interest expense.

As of September 30, 2017, and December 31, 2016, gross unrecognized tax benefits that would affect the effective tax rate if recognized were \$32.3 and \$32.0 million, respectively, which would affect the effective tax rate, if recognized. Over the next twelve months, our existing tax positions will continue to generate increased liabilities for unrecognized tax benefits. It is reasonably possible that our gross unrecognized tax benefits will decrease up to \$5.0 million in the next twelve months. These adjustments, if recognized, would positively impact our effective tax rate, and would be recognized as additional tax benefits in our Condensed Consolidated Statement of Operations. The reduction in unrecognized tax benefits relates primarily to a lapse of the statute of limitations for federal and state tax purposes.

In accordance with ASU 2013-11, we recorded \$19.9 million of gross unrecognized tax benefits as an offset to deferred tax assets as of September 30, 2017, and the remaining \$12.4 million has been recorded as noncurrent income taxes payable.

We recognize potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of September 30, 2017, and December 31, 2016, we have accrued \$0.6 and \$0.5 million, respectively, for potential payments of interest and penalties.

[Table of Contents](#)

As of September 30, 2017, we were subject to examination by the Internal Revenue Service for the 2014-2015 tax years, state tax jurisdictions for the 2012-2015 tax years, the Netherlands tax authority for the 2012-2015 tax years, the Spanish tax authority for the 2013-2016 tax years, the Israel tax authority for the 2011-2015 tax years, and the Italian tax authority for the 2012-2015 tax years.

In *Altera Corp. v. Commissioner*, the U.S Tax Court issued an opinion on July 27, 2015, related to the treatment of stock-based compensation expense in an intercompany cost-sharing arrangement. To date, the U.S. Department of the Treasury has not withdrawn the requirement to include stock-based compensation in intercompany cost-sharing arrangements from its regulations. Due to the uncertainty related to the status of the current regulations and the basis of the appeal that has been filed by the Internal Revenue Service, we have not recorded any benefit as of September 30, 2017, in our Condensed Consolidated Statement of Operations. We will continue to monitor ongoing developments and potential impacts to our condensed consolidated financial statements.

We assess the likelihood that our deferred tax assets will be recovered from future taxable income by considering both positive and negative evidence relating to their recoverability. If we believe that recovery of these deferred tax assets is not more likely than not, we establish a valuation allowance.

Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we considered all available evidence, including recent operating results, projections of future taxable income, our ability to utilize loss and credit carryforwards, and the feasibility of tax planning strategies. Other than valuation allowances on deferred tax assets related to California, Luxembourg, Israel, Netherlands, and Turkey deferred tax assets that will not be realized based on the size of the net operating loss and research and development credits being generated, we have determined that is more likely than not that we will realize the benefit related to all other deferred tax assets. To the extent we increase a valuation allowance, we will include an expense in the Condensed Consolidated Statement of Operations in the period in which such determination is made.

Non-GAAP Financial Information

Use of Non-GAAP Financial Information

To supplement our condensed consolidated financial results prepared in accordance with GAAP, we use non-GAAP measures of net income and earnings per diluted share that are GAAP net income and earnings per diluted share adjusted to exclude certain costs, expenses, and gains.

We believe the presentation of non-GAAP net income and non-GAAP earnings per diluted share provides important supplemental information regarding certain costs, expenses, gains, and significant items that we believe are important to understanding financial and business trends relating to our financial condition and results of operations. Non-GAAP net income and non-GAAP earnings per diluted share are among the primary indicators used by management as a basis for planning and forecasting future periods and by management and our Board of Directors to determine whether our operating performance has met specified targets and thresholds. Management uses non-GAAP net income and non-GAAP earnings per diluted share when evaluating operating performance because it believes the exclusion of the items described below, for which the amounts and/or timing may vary significantly depending on our activities and other factors, facilitates comparability of our operating performance from period to period. We have chosen to provide this information to investors so they can analyze our operating results in the same way that management does and use this information in their assessment of our business and the valuation of our Company.

Use and Economic Substance of Non-GAAP Financial Measures

We compute non-GAAP net income and non-GAAP earnings per diluted share by adjusting GAAP net income and GAAP earnings per diluted share to remove the impact of the amortization of acquisition-related intangibles, stock-based compensation expense, non-cash settlement of vacation liabilities, restructuring and other expense, acquisition-related transaction expenses, costs to integrate such acquisitions into our business, incremental cost of revenue due to the fair value adjustment to inventories acquired in business acquisitions, changes in the fair value of contingent consideration including the related foreign exchange fluctuation impact, revenue recognition review costs and litigation settlement charges, and non-cash interest expense related to our Notes. We use a constant non-GAAP tax rate of 19%, which we believe reflects the long-term average tax rate based on our international structure and geographic distribution of revenue and profit.

[Table of Contents](#)

Ex-Currency. To better understand trends in our business, we believe it is helpful to adjust our Condensed Consolidated Statements of Operations to exclude the impact of year-over-year changes in the translation of foreign currencies into U.S. dollars. This is a non-GAAP measure that is calculated by adjusting revenue, gross profit, and operating expenses by using historical exchange rates in effect during the comparable prior period and removing the balance sheet currency remeasurement impact from interest income and other income, net, including removal of any hedging gains and losses. We refer to these adjustments as “ex-currency.” Management believes the ex-currency measures provide investors with an additional perspective on year-over-year financial trends and enables investors to analyze our operating results in the same way management does. The year-over-year currency impact can be determined as the difference between year-over-year actual growth rates and year-over-year ex-currency growth rates.

These excluded items are described below:

- Inventory acquired in the acquisition of FFPS is required to be recorded at fair value rather than historical cost in accordance with ASC 805. The fair value of FFPS inventory reflects the manufacturing cost plus a portion of the expected gross profit. We have adjusted our cost of revenue to reflect the expected gross profit that was included in the inventory valuation under ASC 805. We believe this adjustment is useful to investors to understand the gross profit trends of our ongoing business.
- Intangible assets acquired to date are being amortized on a straight-line basis.
- Stock-based compensation expense recognized in accordance with ASC 718.
- Non-cash settlement of vacation liabilities through the issuance of RSUs, which are not included in the GAAP presentation of our stock-based compensation expense.
- Restructuring and other consists of:
 - Restructuring charges incurred as we consolidate the number and size of our facilities and, as a result, reduce the size of our workforce.
 - Expenses incurred to integrate businesses acquired of \$0.2 and \$1.0 million during the three and nine months ended September 30, 2017, respectively, and \$0.6 and \$1.5 million during the three and nine months ended September 30, 2016, respectively.
- Acquisition-related transaction costs associated with businesses acquired during the periods reported and anticipated transactions of \$0.6 and \$1.8 million during the three and nine months ended September 30, 2017, respectively, and \$0.4 and \$1.7 million during the three and nine months ended September 30, 2016, respectively.
- Changes in fair value of contingent consideration. Our management determined that we should analyze the total return provided by the investment when evaluating operating results of an acquired entity. The total return consists of operating profit generated from the acquired entity compared to the purchase price paid, including the final amounts paid for contingent consideration without considering any post-acquisition adjustments related to changes in the fair value of the contingent consideration. Because our management believes the final purchase price paid for the acquisition reflects the accounting value assigned to both contingent consideration and to the intangible assets, we exclude the GAAP impact of any adjustments to the fair value of acquisition-related contingent consideration from the operating results of an acquisition in subsequent periods, including the related foreign exchange fluctuation impact. We believe this approach is useful in understanding the long-term return provided by our acquisitions and that investors benefit from a supplemental non-GAAP financial measure that excludes the impact of this adjustment.
- Non-cash interest expense on our Notes. Our Notes may be settled in cash on conversion. We are required to separately account for the liability (debt) and equity (conversion option) components of the Notes in a manner that reflects our non-convertible debt borrowing rate. Accordingly, for GAAP purposes, we are required to amortize a debt discount equal to the fair value of the conversion option as interest expense on our \$345 million of 0.75% convertible senior notes that were issued in a private placement in September 2014 over the term of the Notes.
- Revenue Recognition Review Costs and Litigation Settlements. As described in “Item 9A, Controls and Procedures” of our annual report on Form 10-K, for the year ended December 31, 2016, as amended in Amendment No. 2, our management concluded that we had material weaknesses in our internal control over financial reporting as of December 31, 2016 related to revenue recognition practices and therefore did not maintain effective internal control over financial reporting or effective disclosure controls and procedures, both of which are requirements of the Securities Exchange Act of 1934, as of that date. The review of our revenue recognition practices has required that we expend significant management time and incur significant accounting, legal, and other expenses totaling \$4.7 million during the three and nine months ended September 30, 2017, and we expect to incur additional costs in future periods.

[Table of Contents](#)

We settled, or accrued reserves related to, litigation claims of \$0.1 and \$0.3 million for the three and nine months ended September 30, 2017, respectively, and \$0.1 and \$0.9 million during the three and nine months ended September 30, 2016, respectively.

- *Tax effect of non-GAAP adjustments*. We use a constant non-GAAP tax rate of 19%, which we believe reflects the long-term average tax rate based on our international structure and geographic distribution of revenue and profit. The long-term average tax rate is calculated in accordance with the principles of ASC 740, Income Taxes, after excluding the tax effect of the non-GAAP items described above and \$10.3 million of previously unrecognized tax benefits associated with the 2012 sale of our Foster City building and land, which we recognized in the three and nine months ended September 30, 2016.

Usefulness of Non-GAAP Financial Information to Investors

Our non-GAAP measures, including ex-currency, are not in accordance with or an alternative to GAAP and may be materially different from other non-GAAP measures, including similarly titled non-GAAP measures, used by other companies. The presentation of this additional information should not be considered in isolation from, as a substitute for, or superior to, revenue, gross profit, operating expenses, net income, or earnings per diluted share prepared in accordance with GAAP. Non-GAAP financial measures have limitations in that they do not reflect certain items that may have a material impact upon our reported financial results. We expect to continue to incur expenses of a nature similar to the non-GAAP adjustments described above, and exclusion of these items from our non-GAAP net income and non-GAAP earnings per diluted share should not be construed as an inference that these costs are unusual, infrequent, or non-recurring.

RECONCILIATION OF GAAP NET INCOME TO NON-GAAP NET INCOME
(unaudited)

(in millions, except per share data)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2017	2016	Ex-Currency 2017	2017	2016	Ex-Currency 2017
Net income	\$ 3.5	\$ 17.7	\$ 3.5	\$ 11.0	\$ 25.0	\$ 11.0
Cost of revenue adjustment - FFPS inventory valuation	0.1	—	0.1	1.3	—	1.3
Amortization of identified intangibles assets and in-process R&D	12.3	10.4	12.3	34.8	29.4	34.8
Ex-currency adjustments	—	—	(0.4)	—	—	1.0
Restructuring and other	0.8	1.3	0.8	5.4	5.7	5.4
Stock-based compensation expense	4.6	8.6	4.6	22.5	26.9	22.5
Non-cash settlement of vacation liabilities by issuing RSUs	—	0.1	—	—	2.8	—
General and administrative:						
Acquisition-related transaction costs	0.6	0.4	0.6	1.8	1.7	1.8
Changes in fair value of contingent consideration	0.4	4.3	0.4	2.2	6.3	2.2
Revenue recognition review costs and litigation settlements	4.8	0.1	4.8	5.1	0.9	5.1
Interest income and other income, net						
Non-cash interest expense related to our Notes	3.3	3.1	3.3	9.7	9.2	9.7
Foreign exchange fluctuation related to contingent consideration	0.1	—	0.1	0.1	0.5	0.1
Balance sheet currency remeasurement impact	—	—	(0.4)	—	—	1.3
Tax effect on non-GAAP net income	(5.1)	(18.4)	(4.9)	(17.2)	(27.9)	(17.6)
Non-GAAP net income	<u>\$ 25.4</u>	<u>\$ 27.5</u>	<u>\$ 24.8</u>	<u>\$ 76.7</u>	<u>\$ 80.5</u>	<u>\$ 78.6</u>
Non-GAAP net income per diluted share	<u>\$ 0.54</u>	<u>\$ 0.58</u>	<u>\$ 0.53</u>	<u>\$ 1.63</u>	<u>\$ 1.68</u>	<u>\$ 1.67</u>
Shares for purposes of computing diluted Non-GAAP net income per share	<u>46.9</u>	<u>47.6</u>	<u>46.9</u>	<u>47.1</u>	<u>47.8</u>	<u>47.1</u>

**RECONCILIATION OF GAAP REVENUE BY OPERATING SEGMENT TO
NON-GAAP EX-CURRENCY
(unaudited)**

(in millions)	Three months ended September 30,											
	GAAP		Ex-Currency				GAAP				Ex-Currency	
	2017	Percent of total	Ex-Currency Adjustments	2017	Percent of total	GAAP 2016	Percent of total	Change from 2016 GAAP		Change from 2016 GAAP		
		\$					\$	%	\$	%		
Industrial Inkjet	\$142.9	58%	\$ (3.2)	\$139.7	57%	\$143.0	58%	\$ (0.1)	—%	\$ (3.3)	(2)%	
Productivity Software	37.2	15	(0.4)	36.8	15	39.7	16	(2.5)	(6)	(2.9)	(7)	
Fiery	68.3	27	(0.1)	68.2	28	62.9	26	5.3	9	5.3	8	
Total revenue	<u>\$248.4</u>	<u>100%</u>	<u>\$ (3.7)</u>	<u>\$244.7</u>	<u>100%</u>	<u>\$245.6</u>	<u>100%</u>	<u>\$ 2.7</u>	<u>1%</u>	<u>\$ (0.9)</u>	<u>—%</u>	

(in millions)	Nine months ended September 30,											
	GAAP		Ex-Currency				GAAP				Ex-Currency	
	2017	Percent of total	Ex-Currency Adjustments	2017	Percent of total	GAAP 2016	Percent of total	Change from 2016 GAAP		Change from 2016 GAAP		
		\$					\$	%	\$	%		
Industrial Inkjet	\$407.9	56%	\$ 1.3	\$409.2	56%	\$408.9	56%	\$ (1.0)	—%	\$ 0.3	—%	
Productivity Software	111.3	15	0.3	111.6	15	108.6	15	2.7	3	3.0	3	
Fiery	204.9	28	—	204.9	28	207.9	29	(2.9)	(1)	(3.0)	(1)	
Total revenue	<u>\$724.1</u>	<u>100%</u>	<u>\$ 1.6</u>	<u>\$725.7</u>	<u>100%</u>	<u>\$725.4</u>	<u>100%</u>	<u>\$ (1.2)</u>	<u>—%</u>	<u>\$ 0.3</u>	<u>—%</u>	

**RECONCILIATION OF GAAP REVENUE BY GEOGRAPHIC AREA TO
NON-GAAP EX-CURRENCY
(unaudited)**

(in millions)	Three months ended September 30,											
	GAAP		Ex-Currency				GAAP				Ex-Currency	
	2017	Percent of total	Ex-Currency Adjustments	2017	Percent of total	GAAP 2016	Percent of total	Change from 2016 GAAP		Change from 2016 GAAP		
		\$					\$	%	\$	%		
Americas	\$129.5	52%	\$ (0.4)	\$129.1	53%	\$128.3	52%	\$ 1.2	1%	\$ 0.8	1%	
EMEA	85.1	34	(2.7)	82.4	34	85.0	35	0.1	—	(2.6)	(3)	
APAC	33.8	14	(0.6)	33.2	13	32.3	13	1.5	5	0.9	3	
Total revenue	<u>\$248.4</u>	<u>100%</u>	<u>\$ (3.7)</u>	<u>\$244.7</u>	<u>100%</u>	<u>\$245.6</u>	<u>100%</u>	<u>\$ 2.8</u>	<u>1%</u>	<u>\$ (0.9)</u>	<u>—%</u>	

(in millions)	Nine months ended September 30,											
	GAAP		Ex-Currency				GAAP				Ex-Currency	
	2017	Percent of total	Ex-Currency Adjustments	2017	Percent of total	GAAP 2016	Percent of total	Change from 2016 GAAP		Change from 2016 GAAP		
		\$					\$	%	\$	%		
Americas	\$353.4	49%	\$ (0.6)	\$352.8	49%	\$364.0	50%	\$(10.6)	(3)%	\$(11.2)	(3)%	
EMEA	274.6	38	2.2	276.8	38	264.5	37	10.2	4	12.4	5	
APAC	96.1	13	—	96.1	13	96.9	13	(0.8)	(1)	(0.8)	(1)	
Total revenue	<u>\$724.1</u>	<u>100%</u>	<u>\$ 1.6</u>	<u>\$725.7</u>	<u>100%</u>	<u>\$725.4</u>	<u>100%</u>	<u>\$ (1.2)</u>	<u>—%</u>	<u>\$ 0.4</u>	<u>—%</u>	

**RECONCILIATION OF GROSS PROFIT BY OPERATING SEGMENT TO
NON-GAAP EX-CURRENCY
(unaudited)**

(in millions)	Three months ended September 30,				Nine months ended September 30,			
	GAAP 2017	Ex-Currency Adjustments	Ex-Currency 2017	GAAP 2016	GAAP 2017	Ex-Currency Adjustments	Ex-Currency 2017	GAAP 2016
Industrial Inkjet								
Revenue	\$ 142.9	\$ (3.2)	\$ 139.7	\$ 143.0	\$ 407.9	\$ 1.3	\$ 409.2	\$ 408.9
Gross profit	53.4	(1.7)	51.7	50.4	155.0	0.7	155.7	141.9
Gross profit percentages	37.4%		37.0%	35.3%	38.0%		38.0%	34.7%
Productivity Software								
Revenue	\$ 37.2	\$ (0.4)	\$ 36.8	\$ 39.7	\$ 111.3	\$ 0.3	\$ 111.6	\$ 108.6
Gross profit	26.7	(0.3)	26.4	30.0	81.4	—	81.4	81.0
Gross profit percentages	71.7%		71.7%	75.7%	73.2%		73.0%	74.6%
Fiery								
Revenue	\$ 68.3	\$ (0.1)	\$ 68.2	\$ 62.9	\$ 204.9	0.1	\$ 205.0	\$ 207.9
Gross profit	47.9	—	47.9	45.4	143.8	0.1	143.9	147.9
Gross profit percentages	70.2%		70.2%	72.1%	70.2%		70.2%	71.2%

Operating segment profit (i.e., gross profit) is reconciled to our Condensed Consolidated Statements of Operations during the three and nine months ended September 30, 2017 and 2016 as follows (in thousands):

(in millions)	Three months ended September 30,				Nine months ended September 30,			
	GAAP 2017	Ex-Currency Adjustments	Ex-Currency 2017	GAAP 2016	GAAP 2017	Ex-Currency Adjustments	Ex-Currency 2017	GAAP 2016
Segment gross profit	\$ 128.0	\$ (2.0)	\$ 126.0	\$ 126.0	\$ 380.2	\$ 0.8	\$ 381.0	\$ 370.8
Stock-based compensation expense	(0.5)	—	(0.5)	(0.6)	(2.0)	—	(2.0)	(1.9)
Other items excluded from segment profit	—	—	—	—	—	—	—	(0.3)
Gross profit	<u>\$ 127.5</u>	<u>\$ (2.0)</u>	<u>\$ 125.5</u>	<u>\$ 125.5</u>	<u>\$ 378.2</u>	<u>\$ 0.8</u>	<u>\$ 379.0</u>	<u>\$ 368.6</u>

**RECONCILIATION OF GAAP OPERATING EXPENSES TO
NON-GAAP EX-CURRENCY
(unaudited)**

(in thousands)	Three months ended September 30,							
	GAAP 2017	Ex-Currency		GAAP 2016	GAAP Change from 2016 GAAP		Ex-Currency Change from 2016 GAAP	
		Ex-Currency Adjustments	2017		2016	\$	%	\$
Research and development	\$ 39,585	\$ (580)	\$ 39,005	\$ 36,933	\$ 2,652	7%	\$ 2,072	6%
Sales and marketing	42,269	(679)	41,590	43,060	(791)	(2)	(1,470)	(3)
General and administrative	25,075	(240)	24,835	24,088	987	4	747	3
Restructuring and other	833	(5)	828	1,308	(475)	(36)	(480)	(37)
Amortization of identified intangibles	12,299	(368)	11,931	10,395	1,904	18	1,536	15
Total operating expenses	<u>\$ 120,061</u>	<u>\$ (1,872)</u>	<u>\$ 118,189</u>	<u>\$ 115,784</u>	<u>\$ 4,277</u>	<u>4%</u>	<u>\$ 2,405</u>	<u>2%</u>

[Table of Contents](#)

(in thousands)	Nine months ended September 30,							
	GAAP	Ex-Currency		GAAP	Change from 2016 GAAP		Ex-Currency	
	2017	Ex-Currency Adjustments	2017	2016	\$	%	\$	%
Research and development	\$ 118,201	\$ (392)	\$ 117,809	\$ 111,731	\$ 7,453	7%	\$ 6,078	5%
Sales and marketing	129,018	274	129,292	127,360	1,658	1	1,932	2
General and administrative	67,239	(46)	67,193	66,366	873	1	827	1
Restructuring and other	5,421	43	5,464	5,733	(311)	(5)	(269)	(5)
Amortization of identified intangibles	34,829	(316)	34,513	29,360	5,469	19	5,153	18
Total operating expenses	<u>\$354,708</u>	<u>\$ (437)</u>	<u>\$354,271</u>	<u>\$340,550</u>	<u>\$ 15,142</u>	<u>4%</u>	<u>\$ 13,721</u>	<u>4%</u>

Liquidity and Capital Resources

Overview

Cash, cash equivalents, and short-term investments decreased by \$66.0 million to \$393.8 million as of September 30, 2017, from \$459.7 million as of December 31, 2016. The decrease was primarily due to cash consideration paid for the acquisition of GD, CRC, and FFPS of \$16.7 million, repurchases under our stock repurchase program of \$47.0 million, net settlement of shares for employee common stock related tax liabilities and the stock option exercise price of certain stock options of \$10.0 million, cash payments for property and equipment of \$8.7 million, restricted investment and cash equivalent funding of \$21.5 million related to the lease of the Manchester construction project, acquisition-related contingent consideration payments of \$9.5 million, and debt repayments of \$10.8 million, partially offset by cash flows provided by operating activities of \$42.4 million, proceeds from ESPP purchases and stock option exercises of \$11.7 million, and the impact of foreign exchange rate changes of \$4.2 million.

(in thousands)	September 30, 2017	December 31, 2016	Change
Cash and cash equivalents	\$ 175,830	\$ 164,313	\$ 11,517
Short term investments	217,923	295,428	(77,505)
Total cash, cash equivalents, and short-term investments	<u>\$ 393,753</u>	<u>\$ 459,741</u>	<u>\$(65,988)</u>

(in thousands)	Nine months ended September 30,		
	2017	2016	Change
Net cash provided by operating activities	\$ 42,441	\$ 55,824	\$(13,383)
Net cash provided by (used for) investing activities	30,413	(13,668)	44,081
Net cash used for financing activities	(65,505)	(65,402)	(103)
Effect of foreign exchange rate changes on cash and cash equivalents	4,168	2,158	2,010
Increase (decrease) in cash and cash equivalents	<u>\$ 11,517</u>	<u>\$ (21,088)</u>	<u>\$ 32,605</u>

Cash, cash equivalents, and short-term investments held outside of the U.S. in various foreign subsidiaries were \$116.3 and \$94.2 million as of September 30, 2017, and December 31, 2016, respectively, and will be used to fund local operations and finance international acquisitions. If these funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. federal and state income taxes on some or all of these funds. However, our intent is to indefinitely reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Based on past performance and current expectations, we believe that our cash, cash equivalents, short-term investments, and cash generated from operating activities will satisfy our working capital, capital expenditure, investment, stock repurchase, commitments (see Note 8 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements), and other liquidity requirements associated with our existing operations through at least the next twelve months. We believe that the most strategic uses of our cash resources include business acquisitions, strategic investments to gain access to new technologies, repurchases of shares of our common stock, and working capital. At September 30, 2017, cash, cash equivalents, and short-term investments available were \$393.8 million. We believe that our liquidity position and capital resources are sufficient to meet our operating and working capital needs.

[Table of Contents](#)

Operating Activities

During the nine months ended September 30, 2017, our cash provided by operating activities was approximately \$42.4 million.

Net cash provided by operating activities consists primarily of net income of \$11.0 million and non-cash charges and credits of \$90.4 million, partially offset by the net change in operating assets and liabilities of \$59.0 million. Non-cash charges and credits of \$90.4 million consist primarily of \$48.0 million in depreciation and amortization, \$22.5 million of stock-based compensation expense, non-cash accretion of interest expense of \$11.2 million, provision for bad debts and sales-related allowances of \$10.9 million, provision for inventory obsolescence of \$3.6 million, and other non-cash charges and credits of \$3.3 million, partially offset by deferred tax credits of \$9.1 million. The net change in operating assets and liabilities of \$59.0 million consists primarily of increased gross accounts receivable of \$21.5 million, increased gross inventories of \$29.8 million, increased other current assets of \$12.6 million, and decreased net income taxes payable of \$5.9 million, partially offset by increased accounts payable and accrued liabilities of \$10.9 million.

Accounts Receivable

Our primary source of operating cash flow is the collection of accounts receivable from our customers. One measure of the effectiveness of our collection efforts is average days sales outstanding for accounts receivable (“DSO”). DSOs were 88 and 76 days at September 30, 2017 and December 31, 2016, respectively. We calculate DSO by dividing net accounts receivable at the end of the quarter by revenue recognized during the quarter, multiplied by the total days in the quarter.

DSOs increased during the nine months ended September 30, 2017, compared with December 31, 2016, primarily due to sales with extended payment terms and a non-linear sales cycle resulting in significant billings at the end of the quarter. We expect DSOs to vary from period to period because of changes in the mix of business between direct customers and end user demand driven through the leading printer manufacturers, the effectiveness of our collection efforts both domestically and overseas, and variations in the linearity of our sales. As the percentage of Industrial Inkjet and Productivity Software related revenue increases, we expect DSOs will trend higher. Our DSOs related to the Industrial Inkjet and Productivity Software operating segments are traditionally higher than those related to the significant printer manufacturer customers / distributors in our Fiery operating segment as, historically, these Fiery customers have been granted shorter payment terms and have paid on a more timely basis.

We have facilities in the U.S. and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables with recourse. Trade receivables sold with recourse are generally short-term receivables with payment due dates of less than 10 days from date of sale, which are subject to a servicing obligation. We also have facilities in Spain and Italy that enable us to sell to third parties, on an ongoing basis, certain trade receivables without recourse. Trade receivables sold without recourse are generally short-term receivables with payment due dates of less than one year, which are secured by international letters of credit.

Trade receivables sold cumulatively under these facilities were \$15.3 and \$3.1 million during the nine months ended September 30, 2017 on a recourse and nonrecourse basis, respectively, which approximates the cash received. The receivables that were sold to third parties were removed from the Condensed Consolidated Balance Sheet and were reflected as cash provided by operating activities in the Condensed Consolidated Statements of Cash Flows.

Inventories

Our inventories are procured primarily in support of the Industrial Inkjet and Fiery operating segments. The majority of our Industrial Inkjet products are manufactured internally, while Fiery production is primarily outsourced. The result is lower inventory turnover for Industrial Inkjet inventories compared with Fiery inventories.

Our net inventories increased by \$35.6 million to \$131.9 million at September 30, 2017 from \$96.3 million at December 31, 2016 primarily due to the increase in Industrial Inkjet inventories, including our Nozomi products, launched in the third quarter of 2017, and acquisition of FFPS inventories. Inventory turnover was 3.6 during the quarter ended September 30, 2017 compared with 5.2 turns during the quarter ended December 31, 2016. We calculate inventory turnover by dividing annualized current quarter cost of revenue by ending inventories. In 2016, we introduced the Nozomi single-pass industrial digital inkjet platform, which was launched in the third quarter of 2017 for the corrugated, paper packaging, display printing, and other related markets. The Nozomi printer is a single pass, 1.8-meter, and high speed LED industrial digital inkjet corrugated packaging press for the corrugated, paper packaging, and display printing markets that prints up to 75 linear meters (246 linear feet) per minute.

[Table of Contents](#)

Investing Activities

Acquisitions

On August 14, 2017, we acquired GD for cash consideration of \$3.2 million, net of cash acquired, plus an additional potential future cash earnout, which is contingent on achieving certain revenue and operating profit performance targets. GD provides software to textile and fashion designers for the creation and design of prints and patterns, color matching, and color palette creation and management within our Fiery operating segment.

On May 8, 2017, we acquired CRC from Reynolds for cash consideration of \$7.6 million. CRC provides business process automation software for commercial label and packaging printers included in the Midmarket Print Suite within our Productivity Software operating segment.

On January 31, 2017, we purchased the FFPS business from Xerox for cash consideration of \$5.9 million, plus \$18.0 million of future cash payments, of which \$9.0 million was paid in July 2017 and \$9.0 million is payable in July 2018. The FFPS business manufactures and markets the FFPS DFE, which is a DFE that previously competed with our Fiery DFE.

On June 16, 2016, we purchased Optitex for cash consideration of \$11.6 million, net of cash acquired, plus an additional potential future cash earnout, which is contingent on achieving revenue and operating profit performance targets. Optitex has developed and markets integrated 2D and 3D design software that is shortening the design cycle, reducing our customers' costs, and accelerating the adoption of fast fashion.

On March 1, 2016, we purchased Rialco for cash consideration of \$8.4 million, net of cash acquired, plus an additional potential future cash earnout, which is contingent on achieving revenue and gross profit targets. Rialco is a leading European supplier of dye powders and color products for the textile, digital print, and other decorating industries.

The escrow of \$1.5 million related to the Reggiani acquisition was remitted to us in return for the issuance of shares of common stock during the nine months ended September 30, 2016.

A tax recovery liability of \$1.0 million related to the Cretaprint acquisition was paid during the nine months ended September 30, 2016.

Investments

Proceeds from sales and maturities of marketable securities, net of purchases, were \$77.4 and \$27.3 million during the nine months ended September 30, 2017 and 2016, respectively. We have classified our investment portfolio as "available for sale." Our investments are made with a policy of capital preservation and liquidity as primary objectives. We may hold investments in fixed income debt securities to maturity; however, we may sell an investment at any time if the quality rating of the investment declines, the yield on the investment is no longer attractive, or we have better uses for the cash. Since we invest primarily in investment securities that are highly liquid with a ready market, we believe the purchase, maturity, or sale of our investments has no material impact on our overall liquidity.

Property and Equipment, Net

Our property and equipment additions have historically been funded from operating activities. Net purchases of property and equipment were \$8.7 and \$17.6 million during the nine months ended September 30, 2017 and 2016, respectively, including the 2016 purchase of single pass digital inkjet printer manufacturing and engineering equipment in the Americas and Spain.

Restricted Cash and Investments

We have restricted cash equivalents and investments that are required to be maintained by the lease related to our Manchester, New Hampshire, construction project, which is described more fully in Note 8 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements.

Table of Contents

The funds pledged under the lease represent 115% of the total expenditures made by BTMU through September 30, 2017. The funds are invested in \$20.9 and \$5.8 million of U.S. government securities and cash equivalents, respectively, with a third party trustee and are restricted during the construction period. Upon completion of construction, the funds will be released as cash and cash equivalents. The portion of released funds that represents 100% of the total expenditures made by BTMU will be deposited with BTMU and restricted as collateral until the end of the underlying lease period.

The funds pledged as collateral are invested in U.S. government securities and cash equivalents as of September 30, 2017, and are classified as Level 1 in the fair value hierarchy as more fully defined in Note 5—Investments and Fair Value Measurements of the Notes to Condensed Consolidated Financial Statements.

Financing Activities

Stock Option and ESPP Proceeds

Historically, our recurring cash flows provided by financing activities have been from the receipt of cash from the issuance of common stock through the exercise of stock options and employee purchases of ESPP shares. We received proceeds from the exercise of stock options of \$1.7 and \$0.6 million and employee purchases of ESPP shares of \$10.0 and \$9.8 million during the nine months ended September 30, 2017 and 2016, respectively. While we may continue to receive proceeds from these plans in future periods, the timing and amount of such proceeds are difficult to predict and are contingent on certain factors including the price of our common stock, the timing and number of stock options exercised by employees that had participated in these plans, net settlement options, employee participation in our ESPP, and general market conditions. We anticipate that cash provided from the exercise of stock options will decline as we have shifted to issuance of RSUs, rather than stock options.

Treasury Stock Purchases

The primary use of funds for financing activities during the nine months ended September 30, 2017 and 2016 was \$56.9 and \$65.3 million, respectively, of cash used to repurchase outstanding shares of our common stock. Such repurchases included \$10.0 and \$7.6 million used for net settlement of shares for the exercise price of certain stock options and any tax withholding obligations incurred connected with such exercises and tax withholding obligations that arose on the vesting of RSUs during the nine months ended September 30, 2017 and 2016, respectively.

On November 9, 2015, the board of directors approved the repurchase of \$150 million of outstanding common stock commencing January 1, 2016. On September 11, 2017, the board of directors approved an additional \$125 million for our share repurchase program commencing September 11, 2017. At that time, \$28.8 million remained available for repurchase under the 2015 authorization. The 2017 authorization thereby increased the repurchase authorization to \$153.8 million of our common stock. This authorization expires December 31, 2018. Under this publicly announced plan, we repurchased 1.0 and 1.4 million shares for an aggregate purchase price of \$47.0 and \$57.7 million during the nine months ended September 30, 2017 and 2016, respectively.

Earnout Payments

Cash payments related to earnouts during the nine months ended September 30, 2017 of \$9.5 million are primarily related to the previously accrued Shuttleworth, Rialco, and Reggiani contingent consideration liabilities. Earnout payments during the nine months ended September 30, 2016 of \$1.9 million are primarily related to the previously accrued DirectSmile, SmartLinc, and Metrix contingent consideration liabilities.

Acquisition-related Debt Payments

We paid approximately \$10.8 and \$8.5 million of indebtedness during the nine months ended September 30, 2017 and 2016, respectively, related to the FFPS acquisition or assumed in the Optitex, Matan, and Rialco acquisitions.

Other Commitments

Our Industrial Inkjet inventories consist of materials required for our internal manufacturing operations and finished goods and sub-assemblies purchased from third party contract manufacturers. Raw materials and finished goods, print heads, frames, digital UV curable ink, ceramic digital ink, various textile printing inks, and other components are required to support our internal manufacturing operations. Label and packaging digital inkjet printers, branded textile ink, and certain sub-assemblies are purchased from third party contract manufacturers and branded third party ink manufacturers.

[Table of Contents](#)

Our Fiery inventory consists primarily of raw materials and finished goods, memory subsystems, processors, and ASICs, which are sold to third party contract manufacturers responsible for manufacturing our products. Should we decide to purchase components and manufacture Fiery DFEs internally, or should it become necessary for us to purchase and sell components other than memory subsystems, processors, and ASICs to our contract manufacturers, inventory balances and potentially property and equipment would increase significantly, thereby reducing our available cash resources. Further, the inventories we carry could become obsolete, thereby negatively impacting our financial condition and results of operations.

We are also reliant on several sole source suppliers for certain key components and could experience a significant negative impact on our financial condition and results of operations if such supplies were reduced or not available. We may be required to compensate our subcontract manufacturers for components purchased for orders subsequently cancelled by us. We periodically review the potential liability and the adequacy of the related allowance.

Indemnifications

In the normal course of business and to facilitate the sales of our products, we sometimes indemnify other parties, including customers, lessors, and parties to other transactions with us. When we indemnify these parties, typically those provisions protect other parties against losses arising from our infringement of third party intellectual property rights or other claims made by third parties arising from the use or distribution of our products. Those provisions often contain various limitations including limits on the amount of protection provided.

As permitted under Delaware law, pursuant to our bylaws, charter, and indemnification agreements with our current and former executive officers, directors, and general counsel, we are required, subject to certain limited qualifications, to indemnify our executive officers, directors, and general counsel for certain events or occurrences while the executive officer, director, or general counsel is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the executive officer's, director's, or general counsel's lifetime. The maximum potential future payments we may be obligated to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and may enable us to recover a portion of any future amounts paid.

Legal Proceedings

Please refer to "Part II – Other Information, Item 1: Legal Proceedings" in this Report for more information regarding our legal proceedings.

Off-Balance Sheet Financing

On August 26, 2016, we entered into a lease agreement and have accounted for a lease term of 48.5 years, inclusive of two renewal options of 5.0 and 3.5 years, with the City of Manchester to lease 16.9 acres of land adjacent to the Manchester Regional Airport. The land is subleased to BTMU during the term of the lease related to the manufacturing facility that is being constructed on the site, which is described below. Minimum lease payments are \$13.1 million during the 48.5 year term of the land lease, excluding four months of the land lease that is financed into the manufacturing facility lease.

On August 26, 2016, we entered into a six-year lease with BTMU whereby a 225,000 square foot manufacturing and warehouse facility is under construction related to our super-wide format industrial digital inkjet printer business in the Industrial Inkjet operating segment at a projected cost of \$40 million and a construction period of 18 months. Minimum lease payments during the initial six-year term are \$1.8 million. Upon completion of the initial six-year term, we have the option to renew the lease, purchase the facility, or return the facility to BTMU subject to an 89% residual value guarantee under which we would recognize additional rent expense in the form of a variable rent payment. We have assessed our exposure in relation to the residual value guarantee and believe that there is no deficiency to the guaranteed value with respect to funds expended by BTMU as of September 30, 2017. We are treated as the owner of the facility for federal income tax purposes.

The funds pledged under the lease represent 115% of the total expenditures made by BTMU through September 30, 2017. The funds are invested in \$20.9 and \$6.8 of million U.S. government securities and cash equivalents, respectively, with a third party trustee and will be restricted during the construction period. Upon completion of construction, the funds will be released as cash and cash equivalents. The portion that represents 100% of the total expenditures made by BTMU will be deposited with BTMU and restricted as collateral until the end of the underlying lease period.

[Table of Contents](#)

Contractual Obligations

Please refer to Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Contractual Obligations” presented in our Annual Report on Form 10-K, as amended in Amendment No. 2, during the year ended December 31, 2016. There were no material changes during the nine months ended September 30, 2017.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Market Risk

We are exposed to various market risks. Market risk is the potential loss arising from adverse changes in market rates and prices, general credit, foreign currency exchange rate fluctuations, liquidity, and interest rate risks, which may be exacerbated by the tight global credit market and increase in economic uncertainty that have affected various sectors of the financial market and continue to cause credit and liquidity issues. We do not enter into derivatives or other financial instruments for trading or speculative purposes. We may enter into financial instrument contracts to manage and reduce the impact of changes in foreign currency exchange rates on earnings and cash flows. The counterparties to such contracts are major financial institutions. We hedge our operating expense exposure in Indian rupees. The notional amount of our Indian rupee cash flow hedge was \$3.8 million at September 30, 2017. We hedge balance sheet remeasurement exposures using forward contracts not designated for hedge accounting treatment with notional amounts of \$188.0 million at September 30, 2017 consisting of hedges of British pound sterling, Brazilian real, Israeli shekel, Japanese yen, Chinese renminbi and Euro-denominated intercompany balances with notional amounts of \$99.6 million, hedges of Brazilian real, British pound sterling, Australian dollar, Canadian dollar, Israeli shekel, and Euro-denominated trade receivables with notional amounts of \$46.5 million, and hedges of British pounds sterling, Indian rupee, Israeli shekel, Canadian dollar, and Euro-denominated other net monetary assets with notional amounts of \$41.9 million.

Since Europe represents a significant portion of our revenue and cash flow, SEC encourages disclosure of our European concentrations of credit risk regarding gross receivables, related reserves, and aging on a region or country basis, and the impact on liquidity with respect to estimated timing of receivable payments. Since Europe is composed of varied countries and regional economies, our European risk profile is somewhat more diversified due to the varying economic conditions among the countries. Approximately 32% of our receivables are with European customers as of September 30, 2017. Of this amount, 31% of our European receivables (10% of consolidated receivables) are in the higher risk southern European countries (mostly Italy, Spain, and Portugal), which are adequately reserved.

Marketable Securities

We maintain an investment portfolio of short-term fixed income debt securities of various holdings, types, and maturities. These short-term investments are generally classified as available-for-sale and, consequently, are recorded on our Condensed Consolidated Balance Sheets at fair value with unrealized gains and losses reported as a separate component of OCI. We attempt to limit our exposure to interest rate risk by investing in securities with maturities of less than three years; however, we may be unable to successfully limit our risk to interest rate fluctuations. At any time, a sharp rise in interest rates could have a material adverse impact on the fair value of our investment portfolio. Conversely, declines in interest rates could have a material favorable impact on the fair value of our investment portfolio. Increases or decreases in interest rates could have a material impact on interest earnings related to new investments during the period. We do not currently hedge these interest rate exposures.

Interest Rate Risk

Hypothetical changes in the fair values of financial instruments held by us at September 30, 2017 that are sensitive to changes in interest rates are presented below. The modeling technique measures the change in fair value arising from selected potential changes in interest rates. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 100 basis points over a twelve month time horizon (in thousands):

<u>Valuation of securities given an interest rate decrease of 100 basis points</u>	<u>No change in interest rates</u>	<u>Valuation of securities given an interest rate increase of 100 basis points</u>
<u>\$ 245,295</u>	<u>\$ 242,348</u>	<u>\$ 239,400</u>

[Table of Contents](#)

European investments are required to be disclosed by counterparty (i.e., sovereign and non-sovereign) and by country. We have no European sovereign debt investments. Our European debt and investments consist of non-sovereign corporate debt securities of \$16.1 million, which represents 12% of our corporate debt instruments (7% of our short-term investments) at September 30, 2017. European debt investments are with corporations domiciled in the northern and central European countries of Sweden, Netherlands, Norway, Switzerland, France, and the U.K. We do not have any short-term investments with corporations domiciled in the higher risk “southern European” countries (i.e., Italy, Spain, Greece, and Portugal) or in Ireland. We believe that we do not have significant exposure with respect to our money market and corporate debt investments in Europe.

As of September 30, 2017, we have \$345 million principal amount of Notes outstanding. We carry these instruments at face value less unamortized discount on our Condensed Consolidated Balance Sheets. Since these instruments bear interest at fixed rates, we have no financial statement risk associated with changes in interest rates. Although the fair value of these instruments fluctuates when interest rates change, a substantial portion of the market value of our Notes that exceeds the outstanding principal amount relates to the conversion premium. Please refer to Note 5 – Investments and Fair Value Measurements and Note 6 – Convertible Senior Notes, Note Hedges, and Warrants of the Notes to Condensed Consolidated Financial Statements.

Foreign Currency Exchange Risk

A large portion of our business is conducted in countries other than the U.S. We are primarily exposed to changes in exchange rates for the Euro, British pound sterling, Indian rupee, Japanese yen, Brazilian real, Chinese renminbi, Israeli shekel, New Zealand dollar, and Australian dollar. Although the majority of our receivables are invoiced and collected in U.S. dollars, we have exposure from non-U.S. dollar-denominated sales (consisting of the Euro, British pound sterling, Brazilian real, Chinese renminbi, Israeli shekel, Australian dollar, and Canadian dollar) and operating expenses (primarily the Euro, British pound sterling, Brazilian real, Chinese renminbi, Israeli shekel, Japanese yen, Indian rupee, and Australian dollar) in foreign countries. We can benefit from or be adversely affected by either a weaker or stronger U.S. dollar relative to major currencies worldwide with respect to our condensed consolidated financial statements. Accordingly, we can benefit from a stronger U.S. dollar due to the corresponding reduction in our foreign operating expenses translated in U.S. dollars and at the same time we can be adversely affected by a stronger U.S. dollar due to the corresponding reduction in foreign revenue translated in U.S. dollars.

We hedge our operating expense exposure in Indian rupees. The notional amount of our Indian rupee cash flow hedge was \$3.8 million at September 30, 2017. We hedge balance sheet remeasurement exposures using forward contracts not designated for hedge accounting treatment with notional amounts of \$188.0 million at September 30, 2017 consisting of hedges of British pound sterling, Brazilian real, Israeli shekel, Japanese yen, Chinese renminbi and Euro-denominated intercompany balances with notional amounts of \$99.6 million, hedges of Brazilian real, British pound sterling, Australian dollar, Canadian dollar, Israeli shekel, and Euro-denominated trade receivables with notional amounts of \$46.5 million, and hedges of British pounds sterling, Indian rupee, Israeli shekel, Canadian dollar and Euro-denominated other net monetary assets with notional amounts of \$41.9 million.

The impact of hypothetical changes in foreign exchanges rates on revenue and income from operations are presented below. The modeling technique measures the change in revenue and income from operations resulting from changes in selected foreign exchange rates with respect to the Euro, British pound sterling, and Chinese renminbi of plus or minus one percent during the three months ended September 30, 2017 as follows (in thousands):

	Impact of a foreign exchange rate decrease of one percent	No change in foreign exchange rates	Impact of a foreign exchange rate increase of one percent
Revenue	\$ 726,292	\$ 724,097	\$ 721,902
Income from operations	\$ 24,121	\$ 23,531	\$ 22,941

Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, which are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

[Table of Contents](#)

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2017, the end of the period covered by this interim report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of September 30, 2017, due to material weaknesses in our internal control over financial reporting. Our internal control over financial reporting is the process designed by and under the supervision of our Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements for external reporting in accordance with accounting principles generally accepted in the United States of America.

As described in “Item 9A. Controls and Procedures” of our annual report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016, management performed its assessment of the effectiveness of our internal control over financial reporting as of December 31, 2016, and concluded that our internal control over financial reporting as of that date was not effective because of the material weaknesses described below.

Our management determined that, as of December 31, 2016, the following material weaknesses existed in our internal control over financial reporting:

1. Our internal controls were not designed effectively to ensure that, operational changes which may impact revenue recognition were appropriately and timely evaluated to determine the accounting impact.
2. We did not sufficiently staff, with appropriate levels of experience and training, to allow for the adequate monitoring and timely communication of operational changes, including those which may impact revenue recognition on an ongoing basis.
3. Our internal control over excess and obsolete finished goods printer inventory reserves at our Italian manufacturing subsidiary was not designed effectively to conduct a sufficiently precise evaluation of the classification, condition, and salability of each printer and the cost accounting department was not staffed sufficiently to mitigate limitations relating to these reserves in the ERP system used solely at this subsidiary.

Items #1 and #2 resulted in management not timely identifying and evaluating the appropriate period of recognition for certain revenue transactions related to printers distributed from a single location, which should have been evaluated in accordance with the bill and hold revenue recognition guidance. Item #3 resulted in management not timely evaluating the appropriate period of de-recognition of certain printer inventory manufactured at our Italian manufacturing subsidiary, which should have been subject to an excess and obsolescence impairment or reclassification and depreciation.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected in a timely basis. Because the deficiencies identified could result in a misstatement of revenue, inventory, and related accounts and associated disclosures that could be material to the annual or interim consolidated financial statements, such deficiencies represent material weaknesses in our internal control over financial reporting. Management concluded that its internal control over financial reporting as of December 31, 2016 was not effective due to the material weaknesses described above.

Material Weakness Discussion and Remediation

Management analyzed the impact resulting from the identified material weaknesses and concluded that it did not have a material impact on our previously issued consolidated financial statements. However, due to the effect of recording an out-of-period correction in our current financial statements, management has determined to prospectively restate our financial statements to give effect to the correction related to the excess and obsolescence and related Italian inventory immaterial misstatements when future financial statements are filed. The impact to net income for the years ended December 31, 2016 and 2015 for this correction is a decrease of \$0.6 and \$1.3 million, respectively, from amounts previously reported of \$45.5 and \$33.5 million, respectively.

Notwithstanding the material weaknesses in our internal control over financial reporting, we concluded that our previously issued consolidated financial statements and other financial information included in our filings fairly present in all material respects our financial condition, results of operations, and cash flows as of, and for, the periods presented. The foregoing has been approved by our management, including our Chief Executive Officer and Chief Financial Officer, who have been involved with the reassessment and analysis of our internal control over financial reporting.

The material weaknesses did not result in a material misstatement in the financial statements included in our annual report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016, or previously issued financial statements; however, we concluded that, as of December 31, 2016, there was a reasonable possibility that material misstatements could occur in the consolidated financial statements.

Plan for Remediation of Material Weaknesses

Following the identification of the foregoing material weaknesses, management commenced implementation of a remediation plan, which is ongoing. Management believes that the plan, once complete, will remediate the material weaknesses described above. The following steps of the remediation plan are currently in process, and management may determine to enhance existing controls and/or implement additional controls as the implementation progresses:

- Design and implement controls to properly identify, evaluate and monitor operational changes which may impact revenue recognition;
- Evaluate the sufficiency, experience, and training of our internal personnel and hire additional personnel or use external resources;
- Design and implement controls related to the approval and accounting for any bill and hold transactions;
- Design and implement controls to evaluate excess and obsolete inventory reserves at our Italian subsidiary; and
- Direct our internal auditors to perform additional testing of revenue transactions to ensure the sufficiency of our remediation efforts.

We are in the process of further reviewing, documenting, and testing our internal controls over financial reporting, and we may from time to time make changes aimed at enhancing existing controls and/or implementing additional controls. Because the implementation of our remediation plan was ongoing as of September 30, 2017, and because there was insufficient time as of September 30, 2017, to demonstrate that the new controls implemented as part of the remediation plan were operating effectively as of that date, management concluded that the material weaknesses described in our amended annual report above, remain unremediated as of September 30, 2017.

Important Considerations

The effectiveness of our disclosure controls and procedures and our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, there can be no assurance that any system of disclosure controls and procedures or internal control over financial reporting will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management.

Evaluation of Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management has evaluated changes in our internal control over financial reporting that occurred during the third quarter of 2017. Based on that evaluation, except for the changes described above, our Chief Executive Officer and Chief Financial Officer did not identify any change in our internal control over financial reporting during the third quarter of 2017 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

We may be involved, from time to time, in a variety of claims, lawsuits, investigations, or proceedings relating to contractual disputes, securities laws, intellectual property rights, employment, or other matters that may arise in the normal course of business. We assess our potential liability in each of these matters by using the information available to us. We develop our views on estimated losses in consultation with inside and outside counsel, which involves a subjective analysis of potential results and various combinations of appropriate litigation and settlement strategies. We accrue estimated losses from contingencies if a loss is deemed probable and can be reasonably estimated.

We are subject to the matters discussed below as of the date of this filing:

Purported Class Action Lawsuit

On August 10, 2017, a putative class action was filed against the Company and its two named executive officers in the United States District Court for the District of New Jersey, captioned *Pipitone v. Electronics For Imaging, Inc.*, No. 2:17-cv-05992 (D.N.J.). The complaint alleges, among other things, that statements by the Company and its officers about the Company's financial reporting, revenue recognition, internal controls, and disclosure controls and procedures were false or misleading. The complaint seeks an unspecified amount of damages, interest, attorneys' fees, and other costs, on behalf of a putative class of individuals and entities that purchased or otherwise acquired EFI securities from February 22, 2017 through August 3, 2017.

[Table of Contents](#)

At this time, we do not believe it is probable that we will incur a material loss in this matter. However, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Because this matter is in the preliminary stages, we are not yet in a position to estimate the amount or range of reasonably possible loss that may be incurred.

Purported Derivative Shareholder Lawsuits

On August 22, 2017, a purported derivative shareholder complaint was filed in the Superior Court of the State of California for the County of Alameda captioned *Schiffmiller v. Gecht*, No. RG17873197. The complaint makes claims derivatively and on behalf of the Company as nominal defendant against the Company's named executive officers and directors for alleged breaches of fiduciary duties and unjust enrichment, and alleges, among other things, that statements by the Company and its officers about the Company's financial reporting, revenue recognition, internal controls, and disclosure controls and procedures were false or misleading. The complaint alleges the Company has suffered damage as a result of the individual defendants' alleged actions, and seeks an unspecified amount of damages, restitution, and declaratory and other relief. The derivative action has been stayed pending the resolution of the *Pipitone* class action described above.

At this time, we do not believe it is probable that we will incur a material loss in this matter. However, it is reasonably possible that our financial statements could be materially affected by an unfavorable resolution of this matter. Because this matter has been stayed pending resolution of the *Pipitone* class action described above, we are not yet in a position to estimate the amount or range of reasonably possible loss that may be incurred. Because this matter has been stayed pending resolution of the *Pipitone* class action described above, we are not yet in a position to estimate the amount or range of reasonably possible loss that may be incurred.

MDG Matter

EFI acquired Matan in 2015 from sellers (the "2015 Sellers") that acquired Matan Digital Printing Ltd. from other sellers in 2001 (the "2001 Sellers"). The 2001 Sellers have asserted a claim against the 2015 Sellers and Matan asserting that they are entitled to a portion of the 2015 Sellers' proceeds from EFI's acquisition. The 2015 Sellers dispute this claim and have agreed to indemnify EFI against the 2001 Sellers' claim.

Although we are fully indemnified and we do not believe that it is probable that we will incur a loss, it is reasonably possible that our financial statements could be materially affected by the unfavorable resolution of this matter. Accordingly, it is reasonably possible that we could incur a material loss in this matter. We estimate the range of loss to be between one dollar and \$10.1 million. If we incur a loss in this matter, it will be offset by a receivable of an equal amount representing a claim for indemnification against the escrow account established in connection with the Matan acquisition.

Other Matters

We are subject to various other claims, lawsuits, investigations, and proceedings in addition to the matters discussed above. There is at least a reasonable possibility that additional losses may be incurred in excess of the amounts that we have accrued. However, we believe that these claims are not material to our financial statements or the range of reasonably possible losses is not reasonably estimable. Litigation is inherently unpredictable, and while we believe that we have valid defenses with respect to legal matters pending against us, our financial statements could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies or because of the diversion of management's attention and the incurrence of significant expenses.

Item 1A: Risk Factors

In addition to information regarding risk factors that appears in "Management's Discussion and Analysis – Forward-looking Statements" in Part I, Item 2, of this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A, and Part II, Items 7 and 7A, of our Annual Report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016 (the "2016 Form 10-K"), which could materially affect our business, financial condition, or future results. The risks described herein and in our 2016 Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or operating results.

In addition to the risk factors disclosed in our 2016 Form 10-K, we have identified the following material changes to our risk factors.

We are currently subject to securities lawsuits and we may be subject to similar or other litigation in the future, which may divert management's attention and have a material adverse effect on our business, financial condition and results of operations.

The market price of our common stock declined significantly following our August 3, 2017 announcement concerning our assessment of the timing of recognition of revenue and the effectiveness of our current and historical disclosure controls and internal control over financial reporting. On August 10, 2017, a purported class action lawsuit was filed alleging, among other things, that we and certain of our officers violated federal securities laws by making allegedly false and misleading statements concerning our financial reporting, revenue recognition, internal controls, and disclosure controls and procedures, prior to our August 3, 2017 announcement. The plaintiffs seek unspecified monetary damages on behalf of the putative class and an award of costs and expenses, including attorney's fees. In addition, on August 22, 2017, a purported derivative shareholder complaint was filed alleging, among other things that certain of our officers and our directors had breached fiduciary duties and had been unjustly enriched and had made allegedly false and misleading statements concerning our financial reporting, revenue recognition, internal controls, and disclosure controls and procedures. The complaint alleges that the Company has suffered damage and seeks an unspecified amount of damages, restitution, and declaratory and other relief.

We cannot predict the outcome of these lawsuits and we may be subject to other similar litigation in the future. Monitoring and defending against legal actions, whether or not meritorious, is time-consuming for our management and detracts from our ability to fully focus our internal resources on our business activities. In addition, we may incur substantial legal fees and costs in connection with litigation. Although we have insurance, coverage could be denied or prove to be insufficient. We are not currently able to estimate the possible cost to us from the currently pending lawsuits, and we cannot be certain how long it may take to resolve these matters or the possible amount of any damages that we may be required to pay. We have not established any reserves for any potential liability relating to these or future lawsuits. It is possible that we could, in the future, incur judgments or enter into settlements of claims for monetary damages. A decision adverse to our interests on these actions could result in the payment of substantial damages and could have a material adverse effect on our business, results of operations and financial condition. In addition, the uncertainty of the currently pending lawsuits could lead to more volatility in our stock price.

We identified material weaknesses in our internal control over financial reporting as of December 31, 2016, and the occurrence of these or any other material weaknesses could have a material adverse effect on our ability to report accurate financial information in a timely manner.

As described in "Item 9A, Controls and Procedures" of our annual report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016 ("annual report"), our management concluded that we had material weaknesses in our internal control over financial reporting as of December 31, 2016 related to revenue recognition practices at a single manufacturing location as well as inventory valuation practices at our Italian manufacturing location and therefore did not maintain effective internal control over financial reporting or effective disclosure controls and procedures, both of which are requirements of the Securities Exchange Act of 1934, as of that date. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Following the identification of the material weaknesses, management implemented remediation plans, which are ongoing as of September 30, 2017. Because there was insufficient time as of September 30, 2017, to demonstrate that the new controls implemented as part of the remediation plan were operating effectively as of that date, management concluded that the material weaknesses described in our Annual Report on Form 10-K, as amended in Amendment No. 2, for the year ended December 31, 2016, as amended, still existed as of September 30, 2017.

The remedial measures we are undertaking may not be adequate to prevent future misstatements or avoid other control deficiencies or material weaknesses. The effectiveness of our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, there can be no assurance that any system of disclosure controls and procedures or internal control over financial reporting will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management.

[Table of Contents](#)

If we fail to continue to introduce new products that achieve market acceptance on a timely basis, we will not be able to compete effectively and we will be unable to increase or maintain net revenue and gross margins.

We operate in a highly competitive, quickly changing environment, and our future success depends on our ability to develop or acquire, and introduce new products that achieve broad market acceptance. Our future success will depend in large part upon our ability to identify demand trends and quickly develop or acquire, and manufacture and sell products that satisfy these demands in a cost effective manner. In order to differentiate our products from our competitors' products, we must continue to increase our focus and capital investment in research and development. For example, we have committed substantial resources expressed in both man-hours and financial investment to the development of our Nozomi single-pass industrial digital inkjet platform, which was introduced in 2016 and launched in the third quarter of 2017, for the corrugated, paper packaging, display printing, and other related markets. We have invested significantly in the research and development, sales and marketing, and manufacturing processes required to successfully launch this product. While we have indications of interest from potential customers, we are unable to predict the actual level of demand for this product because Nozomi is a new product and the indications of interest are cancellable and may not ultimately become orders. If this product is not successful in the market, then our condensed consolidated financial position and results of operations could be materially impacted.

Successfully predicting demand trends is difficult, and it is very difficult to predict the effect introducing a new product will have on existing product sales. We will also need to respond effectively to new product announcements by our competitors by quickly introducing competitive products. Any future delays in product development and introduction, or product introductions that do not meet broad market acceptance, or unsuccessful launches of new product lines could result in:

- loss of or delay in revenue and loss of market share;
- negative publicity and damage to our reputation and brand;
- a decline in the average selling price of our products;
- adverse reactions in our sales channels, such as reduced shelf space, reduced online product visibility, or loss of sales channel;
- increased levels of product returns; and
- failure to recover amounts invested

Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

Our stock repurchases during the quarter ended September 30, 2017 are as follows (in thousands, except for per share amounts):

Issuer Purchases of Equity Securities

Total	Total Number of Shares Purchased (2)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans (1)
July 2017	172	\$ 48.51	164	\$ 33,344
August 2017	159	39.70	107	28,802
September 2017	27	35.25	—	153,802
Totals	<u>358</u>	<u>\$ 43.61</u>	<u>271</u>	

(1) In November 2015, our board of directors authorized \$150 million for the repurchase of our outstanding common stock commencing January 1, 2016. On September 11, 2017, the board of directors approved an increase of \$125 million for our share repurchase program commencing September 11, 2017. At that time, \$28.8 million remained available for repurchase under the 2015 authorization. The 2017 authorization thereby increased the repurchase authorization to \$153.8 million of our common stock. This authorization expires December 31, 2018. Under this publicly announced plan, we repurchased 0.3 million shares for an aggregate purchase price of \$12.5 million during the three months ended September 30, 2017.

(2) Includes less than 0.1 million shares purchased from employees to satisfy the exercise price of certain stock options and any tax withholding obligations incurred in connection with such exercises and minimum tax withholding obligations that arose on the vesting of RSUs.

[Table of Contents](#)

Item 3: Defaults Upon Senior Securities

None.

Item 4: Mine Safety Disclosure

Not applicable.

Item 5: Other Information

Correction of Prior Period Information

As discussed in Note 1 to the condensed consolidated financial statements, during the preparation of the condensed consolidated financial statements for the three and nine months ended September 30, 2017, we identified certain errors at our Italian manufacturing subsidiary attributable to the valuation and classification of certain finished goods inventory. The preceding resulted in an understatement of cost of revenue in 2015 and operating expenses in 2016.

We consider the correction to previously issued financial statements to be immaterial.

We plan to prospectively restate our financial statements as they are issued in future filings. The impact to net income for the years ended December 31, 2016 and 2015 for this correction is a decrease of \$0.6 and \$1.3 million, respectively, from amounts previously reported of \$45.5 and \$33.5 million, respectively.

Item 6: Exhibits

<u>No.</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation ⁽¹⁾
3.2	Amended and Restated Bylaws of Electronics For Imaging, Inc. (as amended August 12, 2009) ⁽²⁾
10.1	Form of Restricted Stock Unit Award Grant Notice and Restricted Stock Unit Award Agreement
12.1	Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Filed as an exhibit 3.1 to the Company's Annual Report on Form 10-K filed on February 22, 2017 (File No. 000-18805) and incorporated herein by reference.

(2) Filed as an exhibit 3.2 to the Company's Current Report on Form 8-K filed on August 17, 2009 (File No. 000-18805) and incorporated herein by reference.

EXHIBIT INDEX

<u>No.</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation ⁽¹⁾
3.2	Amended and Restated Bylaws of Electronics For Imaging, Inc. (as amended August 12, 2009) ⁽²⁾
10.1	Form of Restricted Stock Unit Award Grant Notice and Restricted Stock Unit Award Agreement
12.1	Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Filed as an exhibit 3.1 to the Company's Annual Report on Form 10-K filed on February 22, 2017 (File No. 000-18805) and incorporated herein by reference.
- (2) Filed as an exhibit 3.2 to the Company's Current Report on Form 8-K filed on August 17, 2009 (File No. 000-18805) and incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ELECTRONICS FOR IMAGING, INC.

Date: November 27, 2017

/s/ Guy Gecht

Guy Gecht
Chief Executive Officer
(Principal Executive Officer)

Date: November 27, 2017

/s/ Marc Olin

Marc Olin
Chief Financial Officer
(Principal Financial and Accounting Officer)

ELECTRONICS FOR IMAGING, INC.
2017 EQUITY INCENTIVE PLAN
[RESTRICTED STOCK UNIT AWARD AGREEMENT]
[PERFORMANCE STOCK UNIT AWARD AGREEMENT]

THIS [RESTRICTED] [PERFORMANCE] STOCK UNIT AWARD AGREEMENT (this “ **Award Agreement** ”), dated as of [_____, 20 __] by and between Electronics For Imaging, Inc., a Delaware corporation (the “ **Company** ”), and [_____] (the “ **Participant** ”), evidences the award (the “ **Award** ”) granted by the Company to the Participant as to the number of stock units (the “ **Stock Units** ”) first set forth below.

Number of Stock Units ¹ :	[_____]	Award Date:	[_____], 20 __
---	----------	--------------------	-----------------

Vesting : The Award shall vest and become nonforfeitable as follows: *[insert vesting schedule and vesting conditions]*

The Award is granted under the Electronics For Imaging, Inc. 2017 Equity Incentive Plan (the “ **Plan** ”) and subject to the Terms and Conditions of Stock Unit Award, attached hereto as Exhibit A (the “ **Terms** ”) (incorporated herein by this reference) and to the Plan. The Award has been granted to the Participant in addition to, and not in lieu of, any other form of compensation otherwise payable or to be paid to the Participant. Capitalized terms are defined in the Plan if not defined herein. The parties agree to the terms of the Award set forth herein.

By clicking on the Acceptance button below, the Participant agrees to be bound by the terms and conditions of the Plan and this Award Agreement (including the Terms). Participant has reviewed this Award Agreement and the Plan in their entirety and fully understands all provisions of this Award Agreement and the Plan (including, without limitation, the tax withholding provisions in Section 9 of the Terms). Additionally, by clicking on the Acceptance button, the Participant agrees that the Participant has read, fully understands and agrees to abide by the terms of the Company’s Insider Trading Policy and has read and fully understands the Prospectus for the Plan. Participant hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Administrator upon any questions arising under the Plan or relating to the Stock Units.

ELECTRONICS FOR IMAGING, INC.:

By: _____
Print Name: _____

¹ Subject to adjustment under Section 7.1 of the Plan.

EXHIBIT A

TERMS AND CONDITIONS OF STOCK UNIT AWARD

1. Stock Units. As used herein, the term “stock unit” shall mean a non-voting unit of measurement which is deemed for bookkeeping purposes to be equivalent to one outstanding share of the Company’s Common Stock (subject to adjustment as provided in Section 7.1 of the Plan) solely for purposes of the Plan and this Award Agreement. The Stock Units shall be used solely as a device for the determination of the payment to eventually be made to the Participant if such Stock Units vest pursuant to Section 2. The Stock Units shall not be treated as property or as a trust fund of any kind.

2. Vesting. Subject to Section 7 below, the Award shall vest and become nonforfeitable in percentage installments of the aggregate number of Stock Units subject to the Award as set forth on the cover page of this Award Agreement.

3. Continuance of Employment/Service. The vesting schedule requires continued employment or service through each applicable vesting date as a condition to the vesting of the applicable installment of the Award and the rights and benefits under this Award Agreement. Employment or service for only a portion of the vesting period, even if a substantial portion, will not entitle the Participant to any proportionate vesting or avoid or mitigate a termination of rights and benefits upon or following a termination of employment or services as provided in Section 7 below or under the Plan.

Nothing contained in this Award Agreement or the Plan constitutes an employment or service commitment by the Company, affects the Participant’s status as an employee at will who is subject to termination without cause, confers upon the Participant any right to remain employed by or in service to the Company or any Subsidiary, interferes in any way with the right of the Company or any Subsidiary at any time to terminate such employment or services, or affects the right of the Company or any Subsidiary to increase or decrease the Participant’s other compensation or benefits. Nothing in this Award Agreement, however, is intended to adversely affect any independent contractual right of the Participant without his or her consent thereto.

4. Limitation on Rights as a Stockholder; Dividend and Voting Rights. The Participant shall have no rights as a stockholder of the Company, no dividend rights and no voting rights, with respect to the Stock Units and any shares of Common Stock underlying or issuable in respect of such Stock Units until such shares of Common Stock are actually issued to and held of record by the Participant. No adjustments will be made for dividends or other rights of a holder for which the record date is prior to the date of issuance of such shares.

5. Restrictions on Transfer. Neither the Award, nor any interest therein or amount or shares payable in respect thereof may be sold, assigned, transferred, pledged or otherwise disposed of, alienated or encumbered, either voluntarily or involuntarily. The transfer restrictions in the preceding sentence shall not apply to (a) transfers to the Company, or (b) transfers by will or the laws of descent and distribution.

6. Timing and Manner of Payment of Stock Units. On or as soon as administratively practical following each vesting of the applicable portion of the total Award pursuant to Section 2 hereof or Section 7 of the Plan (and in all events not later than two and one-half months after the applicable vesting date), the Company shall deliver to the Participant a number of shares of Common Stock (either by delivering one or more certificates for such shares or by entering such shares in book entry form, as determined by the Company in its discretion) equal to the number of Stock Units subject to the Award that vest on the applicable vesting date, unless such Stock Units terminate prior to the given vesting date pursuant to Section 7. The Company’s obligation to deliver shares of Common Stock or otherwise make payment with respect to vested Stock Units is subject to the condition precedent that the Participant or other person entitled under the Plan to receive any shares with respect to the vested Stock Units deliver to the Company any representations or other documents or assurances required pursuant to Section 8.1 of the Plan. The Participant shall have no further rights with respect to any Stock Units that are paid or that terminate pursuant to Section 7.

7. Effect of Termination of Employment or Service. The Participant’s Stock Units shall terminate to the extent such units have not become vested prior to the first date the Participant is no longer employed by or in service to the Company or one of its Subsidiaries, regardless of the reason for the termination of the Participant’s employment or service with the Company or a Subsidiary, whether with or without cause, voluntarily or involuntarily. If any unvested Stock Units are terminated hereunder, such Stock Units shall automatically terminate and be cancelled as of the applicable termination date without payment of any consideration by the Company and without any other action by the Participant, or the Participant’s beneficiary or personal representative, as the case may be.

8. Adjustments Upon Specified Events. Upon the occurrence of certain events relating to the Company's stock contemplated by Section 7.1 of the Plan (including, without limitation, an extraordinary cash dividend on such stock), the Administrator shall make adjustments in accordance with such section in the number of Stock Units then outstanding and the number and kind of securities that may be issued in respect of the Award.

9. Tax Withholding. Notwithstanding anything to the contrary in this Agreement, the Company shall be entitled to require payment by Participant of any sums required by applicable law to be withheld with respect to the grant of RSUs or the issuance of shares of Stock. Such payment shall be made by deduction from other compensation payable to Participant or in such other form of consideration acceptable to the Company which may, in the sole discretion of the Company, include: (a) cash or check; (b) a reduction in the shares of Common Stock otherwise deliverable under the Award by a number of shares having a fair market value (as determined under the Plan) on the date of delivery equal to up to the maximum amount required to be withheld by statute; or (c) other property acceptable to the Company in its sole discretion (including, without limitation, through the delivery of a notice that the Participant has placed a market sell order with a broker with respect to shares of Common Stock then issuable under the Stock Units, and that the broker has been directed to pay a sufficient portion of the net proceeds of the sale to the Company in satisfaction of its withholding obligations; *provided* that payment of such proceeds is then made to the Company upon settlement of such sale). The Company shall not be obligated to deliver any new certificate representing shares of Common Stock to Participant or Participant's legal representative or enter such shares in book entry form unless and until Participant or Participant's legal representative shall have paid or otherwise satisfied in full the amount of all federal, state and local taxes applicable to the taxable income of Participant resulting from the grant of the Stock Units or the issuance of shares in respect thereof.

10. Notices. Any notice to be given under the terms of this Award Agreement shall be in writing and addressed to the Company at its principal office to the attention of the Secretary, and to the Participant at the Participant's last address reflected on the Company's payroll records. Any notice shall be delivered in person or shall be enclosed in a properly sealed envelope, addressed as aforesaid, registered or certified, and deposited (postage and registry or certification fee prepaid) in a post office or branch post office regularly maintained by the United States Government. Any such notice shall be given only when received, but if the Participant is no longer an Eligible Person, shall be deemed to have been duly given five business days after the date mailed in accordance with the foregoing provisions of this Section 10.

11. Plan. The Award and all rights of the Participant under this Award Agreement are subject to the terms and conditions of the provisions of the Plan, incorporated herein by reference. The Participant agrees to be bound by the terms of the Plan and this Award Agreement. The Participant acknowledges having read and understanding the Plan, the Prospectus for the Plan, and this Award Agreement. Unless otherwise expressly provided in other sections of this Award Agreement, provisions of the Plan that confer discretionary authority on the Board or the Administrator do not (and shall not be deemed to) create any rights in the Participant unless such rights are expressly set forth herein or are otherwise in the sole discretion of the Board or the Administrator so conferred by appropriate action of the Board or the Administrator under the Plan after the date hereof.

12. Entire Agreement. This Award Agreement and the Plan together constitute the entire agreement and supersede all prior understandings and agreements, written or oral, of the parties hereto with respect to the subject matter hereof. The Plan and this Award Agreement may be amended pursuant to Section 8.6 of the Plan. Such amendment must be in writing and signed by the Company. The Company may, however, unilaterally waive any provision hereof in writing to the extent such waiver does not adversely affect the interests of the Participant hereunder, but no such waiver shall operate as or be construed to be a subsequent waiver of the same provision or a waiver of any other provision hereof.

13. Limitation on Participant's Rights. Participation in the Plan confers no rights or interests other than as herein provided. This Award Agreement creates only a contractual obligation on the part of the Company as to amounts payable and shall not be construed as creating a trust. Neither the Plan nor any underlying program, in and of itself, has any assets. The Participant shall have only the rights of a general unsecured creditor of the Company with respect to amounts credited and benefits payable, if any, with respect to the Stock Units, and rights no greater than the right to receive the Common Stock as a general unsecured creditor with respect to Stock Units, as and when payable hereunder.

14. Counterparts. This Award Agreement may be executed simultaneously in any number of counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

15. Section Headings. The section headings of this Award Agreement are for convenience of reference only and shall not be deemed to alter or affect any provision hereof.

16. Governing Law. This Award Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Delaware without regard to conflict of law principles thereunder.

17. Construction. It is intended that the terms of the Award will not result in the imposition of any tax liability pursuant to Section 409A of the Code. This Award Agreement shall be construed and interpreted consistent with that intent.

18. Clawback Policy. The Stock Units are subject to the terms of the Company's recoupment, clawback or similar policy as it may be in effect from time to time, as well as any similar provisions of applicable law, any of which could in certain circumstances require repayment or forfeiture of the Stock Units or any shares of Common Stock or other cash or property received with respect to the Stock Units (including any value received from a disposition of the shares acquired upon payment of the Stock Units).

19. No Advice Regarding Grant. The Participant is hereby advised to consult with his or her own tax, legal and/or investment advisors with respect to any advice the Participant may determine is needed or appropriate with respect to the Stock Units (including, without limitation, to determine the foreign, state, local, estate and/or gift tax consequences with respect to the Award). Neither the Company nor any of its officers, directors, affiliates or advisors makes any representation (except for the terms and conditions expressly set forth in this Award Agreement) or recommendation with respect to the Award. Except for the withholding rights set forth in Section 9 above, the Participant is solely responsible for any and all tax liability that may arise with respect to the Award.

Electronics For Imaging, Inc.
Computation of Ratio of Earnings to Fixed Charges
(in thousands, except for ratio of earnings to fixed charges)

	Years Ended December 31,					Nine Months Ended September 30, 2017
	2012	2013	2014	2015	2016	
Income (loss) from continuing operations before income taxes	\$35,023	\$173,138	\$42,087	\$35,568	\$38,648	\$ 11,795
Fixed charges:						
Interest expense	709	3,406	5,859	17,364	17,716	14,538
Interest relating to rental expense ⁽¹⁾	1,912	2,024	2,039	2,530	2,924	1,961
Total fixed charges	2,621	5,430	7,898	19,894	20,640	16,499
Earnings available for fixed charges	\$37,644	\$178,568	\$49,985	\$55,462	\$59,288	\$ 28,294
Ratio of earnings to fixed charges	14.37	32.89	6.33	2.79	2.87	1.71

- (1) The representative interest portion of rental expense was deemed to be one-third of all rental expense, except for the rental expense related to off-balance sheet financing leases, which was deemed to be all interest.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Guy Gecht, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Electronics For Imaging, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 27, 2017

/s/ Guy Gecht

Guy Gecht

Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Marc Olin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Electronics For Imaging, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 27, 2017

/s/ Marc Olin

Marc Olin

Chief Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Electronics For Imaging, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2017 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 27, 2017

/s/ Guy Gecht

Guy Gecht
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Electronics For Imaging, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2017 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 27, 2017

/s/ Marc Olin

Marc Olin
Chief Financial Officer