SHUTTERFLY INC

2013 ANNUAL REPORT

2013

Letter to Stockholders

Dear Shutterfly Stockholder,

As I reflect on the performance of our team at Shutterfly, Inc., 2013 was another outstanding year for our brands, customers and investors - we delivered record financial results, substantially grew our customer base, enhanced our manufacturing capabilities, expanded our portfolio of premium lifestyle brands to seven and extended our leadership in the multi-billion dollar memories and social expression market segments as we continue to make it easier for consumers to manage, share and preserve their precious memories.

Net revenues reached a record $784 million, a 22% increase over 2012 driven by a healthy 15% growth in our customer base, which resulted in 8.1 million unique transacting customers in 2013. Focused on driving profitable, revenue growth, Shutterfly delivered record adjusted EBITDA of $150 million and record free cash flows of $75 million, representing growth of 17% and 12%, respectively. Through 2013, we have delivered fifty-two consecutive quarters of revenue growth, and seven straight years of solid adjusted EBITDA growth since Shutterfly went public. In fact, adjusted EBITDA profits have grown at a compound annual growth rate of nearly 32% since Shutterfly went public in late 2006.

During the year, we continued to optimize our manufacturing capabilities and supply chain, further extending our competitive position. In June, we opened our new state-of-the-art production facility located in Fort Mill, South Carolina. Our Fort Mill expansion triples the capacity of our south east manufacturing footprint, reduces the time to market for new product introductions and creates opportunities to in-source more of our order volume and add new product offerings for our Consumer and Enterprise businesses. We anticipate that over time, this will drive higher product margins across our lifestyle brands. In September, we broke ground on our new Shakopee, Minnesota production facility. Once complete, Shutterfly will have four production facilities located in the West, Midwest, Northeast, and Southeast, enabling us to better serve our customers, support our next day delivery strategy, provide a level of redundancy in our manufacturing network and supply chain and further increase customer satisfaction levels.

In addition to enhancing our manufacturing capabilities, in 2013 we also invested in a new storage and co-location center that will improve our long-term cost structure while improving our capabilities. Combined, our new manufacturing and co-location facilities are envisaged to generate meaningful operating savings and drive margin leverage beginning in 2015.

We also continue to augment our organic growth by leveraging our market position and strong balance sheet to make disciplined strategic acquisitions. In 2013, we acquired three businesses: MyPublisher, which expands our customer base and further differentiates our product offerings; R&R Images, which immediately added new in-house printing capabilities; and BorrowLenses, which enables the ability to cross-sell new services and diversifies our revenue streams. These acquisitions have allowed us to expand our portfolio of premium lifestyle brands, help to grow our business, increase our rate of innovation, reduce our time to market, and deepen our overall market penetration.

In closing, as we look at how our markets continue to evolve and consider the strengths of our business, we cannot help but remain confident in our strategy and our ability to address many of these emerging consumer challenges. I would like to extend my sincere thanks to all of our customers for their loyalty, and on behalf of the Shutterfly team, I thank our stockholders for their continued support.

Sincerely,

Jeff Housenbold, President & CEO

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

or

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

For the transition period from to

Commission file number 001-33031

SHUTTERFLY, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.0001 Par Value Per Share	Nasdaq Global Market

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

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

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

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

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

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

Large accelerated Filer ☒	Accelerated Filer ☐
Non-accelerated Filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐

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

As of June 28, 2013, the last business day of our most recently completed second fiscal quarter, the aggregate market value of our Common Stock held by non-affiliates based on the closing price of our Common Stock on June 28, 2013 as reported on the NASDAQ Global Select Market was $2,104,507,024.

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

Class	Outstanding at February 10, 2014
Common stock, $0.0001 par value per share	38,237,401

DOCUMENTS INCORPORATED BY REFERENCE

Designated portions of the Proxy Statement relating to the 2014 Annual Meeting of the Stockholders (the "Proxy Statement") have been incorporated by reference into Part III (Items 10, 11, 12, 13 and 14) of this Form 10-K, as specified in the responses to the item numbers involved. Except for information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

Shutterfly, Inc.
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PART I

Except for historical financial information contained herein, the matters discussed in this Form 10-K may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and subject to the safe harbor created by the Securities Litigation Reform Act of 1995. Such statements include declarations regarding our intent, belief, or current expectations and those of management. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks, uncertainties and other factors, some of which are beyond our control; actual results could differ materially from those indicated by such forward-looking statements. Important factors that could cause actual results to differ materially from those indicated by such forward-looking statements include, but are not limited to: (i) that the information is of a preliminary nature and may be subject to further adjustment; (ii) those risks and uncertainties identified under "Risk Factors;" and (iii) the other risks detailed from time-to-time in our reports and registration statements filed with the Securities and Exchange Commission, or SEC. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1. *BUSINESS.*

Overview

Shutterfly, Inc. was incorporated in Delaware in 1999. In September 2006, we completed our initial public offering and our common stock is listed on the NASDAQ Global Select Market under the symbol "SFLY." Our principal corporate offices are located in Redwood City, California.

We are the leading manufacturer and digital retailer of high-quality personalized products and services offered through a family of lifestyle brands. Our vision is to make the world a better place by helping people share life's joy. Our mission is to build an unrivaled service that enables deeper, more personal relationships between our customers and those who matter most in their lives. Our primary focus is on helping consumers manage their memories through the powerful medium of photography. We provide a full range of personalized photo-based products and services that make it easy, convenient and fun for consumers to upload, edit, enhance, organize, find, share, create, print, and preserve their memories in a creative and thoughtful manner.

We operate seven trusted premium lifestyle brands: Shutterfly, Tiny Prints, Wedding Paper Divas, Treat, ThisLife, MyPublisher and BorrowLenses.

Shutterfly leads the market in digital personalized photo products and services. Shutterfly helps our customers turn their precious memories into lasting keepsakes with award-winning photo books, personalized holiday cards, announcements, invitations and stationery, as well as custom home decor products and unique photo gifts. Our online photo service helps our customers stay connected with family and friends, empowering them to do more with their pictures by expressing themselves in extraordinary ways.

TinyPrints is the leading online cards and stationery boutique, offering stylish announcements, invitations and personal stationery for every occasion. Started by three friends with big dreams and a passion for beautiful paper, Tiny Prints has grown from a tiny self-funded company specializing in unique baby stationery to a booming online destination for stylish stationery, for every occasion. Customers (celebrities and top designers alike) seek us out for our fresh designs, premium paper and

exceptional customer service. Tiny Prints makes it easy for customers to connect, keep in touch and transform life's joys into lasting impressions.

Wedding Paper Divas offers stylish and personalized save the dates, wedding invitations, thank you cards, bridal invitations and more — all designed by leading artists in the industry. Unlike most stationery brands, which simply provide a something-for-anyone offering, Wedding Paper Divas works with talented artists all over the country to translate the hottest new trends into perfectly unique products. Regardless of style or budget, Wedding Paper Divas offers better-than-boutique service with one-on-one design and etiquette expertise from wedding stationery specialists. Wedding Paper Divas uses the highest quality paper and offers a promise of complete satisfaction.

Treat is an online destination where customers can create one-of-a-kind personalized greeting cards from an iPhone or any computer in minutes. Treat is all about customizing, personalizing and making standout cards that could only come from our customers. Our cards offer a more personal and meaningful alternative to store-bought greeting cards, giving customers the power to add their sentiments and photos. Treat's reminder service makes sure customers never miss a birthday, anniversary or important milestone. Treat is fun and easy to use, but most importantly, it helps connect customers with all the people in their lives in a truly personal way.

ThisLife is a new service that gathers and organizes your photos and videos so you can easily find, share and enjoy them anywhere. Its smart technology includes facial recognition, search functionality and easy photo importing. With ThisLife, it's easy to manage your photos and find just the ones you want to turn into Shutterfly photo books, cards and gifts.

MyPublisher is where you can create custom photo books, share great memories and tell your story using your photos. We have a variety of book sizes for any occasion from our smallest Mini Books and Pocketbooks to our larger Classic Hardcovers and Deluxe Hardcovers. MyPublisher allows you to create, customize and share all your favorite moments. You are the author of this story, so tell it the best way possible, in a MyPublisher photo book.

BorrowLenses is a premier online marketplace for high-quality photographic and video equipment rentals. This service includes great gear selection, exceptional customer service and dependable and convenient shipping and pick-up options.

We generate the majority of our revenues by producing and selling professionally-bound photo books, greeting and stationery cards, personalized calendars, other photo-based merchandise and high-quality prints ranging in size from wallet-sized to jumbo-sized 20x30 enlargements. We manufacture most of these items in our Fort Mill, South Carolina, Phoenix, Arizona and Elmsford, New York production facilities. In 2013, we entered into leases for new facilities in Shakopee, Minnesota and Tempe, Arizona which are expected to be operational in 2014 and 2015, respectively. By controlling the production process in our own production facilities, we are able to produce high-quality products, innovate rapidly, maintain a favorable cost structure and ensure timely shipment to customers, even during peak periods of demand. Additionally, we sell a variety of photo-based merchandise that is currently manufactured for us by third parties, such as calendars, mugs, canvas prints, mouse pads, magnets, and puzzles. We generate substantially all of our revenue from sales originating in the United States and our sales cycle has historically been highly seasonal as we generate more than 50% of our total net revenues during our fiscal fourth quarter.

Our high-quality products and services and the compelling online experience we create for our customers, combined with our focus on continuous innovation, have allowed us to establish premium

brands. We realize the benefits of premium brands through high customer loyalty, low customer acquisition costs and premium pricing.

Our customers are a central part of our business model. They generate most of the content on our service by uploading their photos and storing their memories. In addition, they share their photos electronically with their friends and families, extending and endorsing our brand and creating a sense of community. Finally, by giving our branded products to colleagues, friends and loved ones throughout the year, customers reinforce our brands. Through these various activities, our customers create a viral network of new users and customers.

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

Our operations and financial performance depend on general economic conditions in the United States, consumer sentiment and levels of consumer discretionary spending. We closely monitor these economic measures as their trends are indicators of the health of the overall economy and are some of the key external factors that impact our business.

Business and Marketing Strategy

We drive business and marketing strategies within two key categories: Consumer and Enterprise. To support our business strategies within these categories, we use a variety of integrated marketing programs, including advertising, direct marketing technologies, and strategic alliances. These methods include direct marketing over the Internet, e-mail marketing to prospects and existing customers, search engine marketing, strategic marketing relationships, traditional direct marketing mailings such as postcards and seasonal catalogs, and a national cable TV campaign during the holiday season. In addition, because many of our products are either shared over the Internet or given as gifts, the appearance of our brands on the products and packaging provides ongoing viral advertising. We place targeted advertisements on websites and in publications, contract for targeted e-mail marketing services and contract for advertising placement on leading search engines.

In addition, to support our Enterprise category, we have hired a small sales force to engage with marketing fulfillment organizations and advertisers for Enterprise services.

The following paragraphs summarize our business strategies within these two categories:

Consumer

Our Consumer revenues include sales from all seven of our brands and are derived from the sale of photo-based products, such as photo books, stationery and greeting cards, other photo-based merchandise, photo prints, and the related shipping revenues as well as rental revenue from our BorrowLenses brand. Included in our photo-based merchandise are items such as mugs, mouse pads, desktop plaques and puzzles. Photo prints consist of wallet, 4x6, 5x7, 8x10, and large format sizes. In addition, Consumer revenues also includes revenues from advertising and sponsorship activities. We also provide website services which include our share platform called Share Sites and our recently launched enhanced cloud

service, called ThisLife. Consumer revenues as a percentage of total net revenues were 95% in 2013, 96% in 2012 and 97% in 2011. Within this category, we seek to drive the following strategies:

- *Continue to grow and optimize our core brands.*

  We have a primary strategy to grow our core Shutterfly and Tiny Prints brands by acquiring new customers, expanding the lifetime value of our existing customers, and improving conversion rates. In 2013, we acquired MyPublisher and began to introduce their customer base to the other products and services of our Shutterfly and Tiny Prints brands. In 2012, we acquired over five billion of Kodak Gallery customer photos and migrated those customers onto the Shutterfly platform. Also in 2012, we offered SeeHere.com customers an opportunity to transfer photos from their SeeHere.com accounts to our Shutterfly platform. Our Share Sites platform, as well as our integrated marketing campaigns and Internet marketing are also a significant source of our new customer registrations.

  We intend to increase repeat orders per customer by expanding our products and services, tailoring our offerings to encourage additional purchases for different holidays and life events and increasing our cross-selling and up-selling activities. In 2013, we added more styles and premium content and options across our brands. We have specifically focused on features that make it easier for customers to personalize products, such as our Custom Path photo book creation solution which we launched in 2011; as well as the integration of advanced image analysis and selection technologies from our acquisition of Photoccino into some of our product creation solutions to a select set of customers. Finally, we intend to continue our efforts to promote and cross-sell products across our various brands, such as Shutterfly photo books and calendars on the Tiny Prints brand website.

- *Invest in early stage strategic growth initiatives.*

  We have made investments in key, early stage initiatives. In 2013, we introduced our first ever photobook creation app for the iPad, making it possible to create digital and physical photo books with enhanced multimedia features. Also in 2013, we launched the beta version of our enhanced cloud service, ThisLife, where consumers can now gather and organize photos and videos from across devices, cloud services and social networks. In addition, we further leveraged the capabilities of the team and technology from our 2012 acquisition of Photoccino, incorporating proprietary algorithms in to our intelligent product creation paths.

  We intend to continue our efforts to develop products and services for Treat, and within the Wedding and Mobile categories. In addition, we plan to make continued improvements in our platform and infrastructure including our big data strategy and analytics, e-commerce development, and manufacturing scale and automation. In particular, the scale and scope economies from our vertically integrated manufacturing and supply chain enable us to extend our competitive position and improve overall customer satisfaction, further strengthening the barriers to success in our industry. In June 2013, we opened our new state-of-the-art production facility located in Fort Mill, South Carolina, tripling our southeast manufacturing footprint, reducing the time to market for new product introductions and enabling greater in-sourcing of our order volumes. In late 2013, we began construction of our new Shakopee, Minnesota production facility, which will provide us with production facilities in the Midwest, to round out our

current West, Northeast, and Southeast capabilities. We believe that this expanded manufacturing footprint will provide a level of redundancy in our manufacturing network and supply chain, further support our scale needs and fulfillment strategies and ultimately increase customer satisfaction levels. We have also begun preliminary work on the build out of a new facility in the Phoenix, Arizona area that consolidates all of our Arizona operations and which we estimate will be operational in 2015.

- *Expand and enhance our brand equity.*

  We seek to delight our customers by offering robust solutions and to expand and enhance our brand equity through all consumer touch points — marketing, business development, multi-brand site experiences and customer service. During 2013, we partnered with various companies to offer our products through multiple nationwide flash promotions to those companies' members, and partnered with retailers, like Best Buy, to promote Shutterfly products at retail outlets. We continue to offer alternate sales channels for our products in retail outlets through our relationships with Target, Inc., CVS/pharmacy, and Walgreens stores. These relationships provide our customers with the option to pick up 4x6 prints at many of these retail locations across the United States. During 2013, we also expanded our use of television and radio advertising campaigns, targeting new customers from our core demographic on various cable channels and radio stations. We believe these efforts will drive increased awareness of our brands and our product offerings, as well as increase the engagement of existing customers.

- *Attract, retain, and grow our leadership team.*

  In order to successfully execute our strategies, we require a talented leadership team. As a result, we intend to continue our focus to attract, retain, and grow our team; and to build continuity and pursue executional excellence in our daily operations everywhere. By providing our employees with a great place to work, we believe that we continue to strengthen our high performance culture.

- *Maintain financial discipline.*

  We manage our business activities with a focus on continued revenue and profitability growth. Our financial strategy involves growing revenues across our brands and initiatives to take advantage of the multi-billion dollar social expression and personal publishing markets, but in a way that generates continued adjusted EBITDA growth.

  We continued to augment our organic growth by making disciplined, strategic acquisitions. In 2013, we acquired MyPublisher, which expanded our customer base and further differentiated our product offerings; R&R Images, which added new in-house printing capabilities, such as for foil-stamped cards; and BorrowLenses, which will facilitate the incorporation of more of life's memories onto the Shutterfly platform and enable our ability to cross-sell new services and diversify our revenue streams.

Enterprise

In order to use available manufacturing capacity during low volume periods and to leverage our large installed base of digital presses, we provide Enterprise services primarily to the direct marketing industry. Our Enterprise revenues are derived from the printing and shipping of direct marketing and other variable

data print products and formats. We continue to focus our efforts in expanding our presence in this market. Enterprise revenues as a percentage of total net revenues were 5% in 2013, 4% in 2012 and 3% in 2011.

Technology and Production Systems

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

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

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

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

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

Image archive. We store our customers' images in our image archive. Once a customer uploads a photo to our website, it is copied to multiple redundant systems, including an off-site copy. We continue to expand our storage capacity to meet increasing customer demand. Our innovative storage architecture provides low storage costs, facilitates the safe, secure archiving of customers' images and delivers the speed and performance required to enable customers to access, enhance and edit their images in real-time.

Render farm. Once a customer orders a photo or any photo-based product, our render farm technology performs fully automated image processing on the image prior to production. The customer's original uploaded image is retrieved from the image archive, and automatic algorithms enhance the color, contrast and sharpness of the image. The render farm also performs customer-requested edits such as crop, borders, customized back-printing and red-eye removal.

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

Production system. We operate our own production facilities in Fort Mill, South Carolina, Phoenix, Arizona and Elmsford, New York. Our automated production system controls our production processes, including order management and pick, pack and ship operations. Using proprietary algorithms, the production system analyzes tens of thousands of orders daily and automates the workflow into our state-of-the-art digital presses.

Competition

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

- Online digital photography services companies such as Snapfish, which is a service of Hewlett-Packard, American Greetings' Webshots brand, Vistaprint, SmugMug, and many others;

- Social media companies that host and enable mobile access to and posting of images such as Facebook, Twitter, and Myspace;

- Photo hosting websites that allow users to upload and share images at no cost such as Picasa, Flickr, and Photobucket;

- "Big Box" retailers such as Wal-Mart, Costco, Sam's Club, and others that are seeking to offer low cost digital photography products and services. These competitors provide in-store fulfillment and self-service kiosks for printing, and may, among other strategies, offer their customers heavily discounted in-store products and services that compete directly with our offerings;

- Drug stores such as Walgreens, CVS/pharmacy, and others that offer in-store pick-up from their photo website internet orders;

- Mobile digital photography services companies such as Instagram (acquired by Facebook), Woven, and iPhoto;

- Self-publishing companies and services such as Lulu, CafePress, and Zazzle;

- Cloud-based storage services and file-syncing services such as Dropbox, SugarSync, Box, Amazon Cloud Drive, and iCloud;

- Specialized companies in the photo book and stationery business such as Hallmark, Cardstore by American Greetings, Minted, Picaboo, Blurb, Mixbook, MOO, Smilebox, Creative Memories, and Photobook America;

- Photo-related software companies such as Apple, Microsoft, Corel, and FotoFlexer;

- Internet portals and search engines such as Yahoo!, AOL, and Google that offer broad-reaching digital photography and related products and services to their large user bases;

- Home printing service providers such as Hewlett-Packard, Epson, Canon, and Kodak that are seeking to expand their printer and ink businesses by gaining market share in the digital photography marketplace;

- Regional photography companies such as Ritz Camera that have established brands and customer bases in existing photography markets; and

- Camera and photographic supply companies that rent equipment nationwide both online and in brick-and-mortar stores such as LensRentals.com, LensProToGo, Cameralends, AbelCine, and Adorama.

We believe the primary competitive factors in attracting and retaining customers are:

- brand recognition and trust;
- quality of products and services;
- breadth of products and services;
- user affinity and loyalty;
- customer service;
- ease of use;
- convenience; and
- price.

We believe that we compete favorably with respect to many of these factors, particularly customer trust and loyalty, quality and breadth of products and services, and customer service. Many of our competitors promote their products on the basis of low prices or the convenience of same-day availability for digital photos printed in drugstores or other retail outlets. Generally, we distinguish ourselves from such competitors principally on the basis of product quality and innovation, rather than price or same-day delivery.

Intellectual Property

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

As of December 31, 2013, we had 65 issued patents, which expire at various dates between 2019 and 2031, and more than 40 patent applications pending in the United States. Our issued patents and patent applications relate primarily to intelligent production creation; image uploading, sharing, and editing; ordering and sharing products; cloud image storage infrastructure; manufacturing optimization; and mobile and social media technologies. We intend to pursue corresponding patent coverage in additional countries to the extent we believe such coverage is appropriate and cost efficient. However, we cannot be certain that any of our pending or any future applications will be granted. In addition, third parties could bring invalidity, co-inventorship or similar claims with respect to any of our currently issued patents or any patents that may be issued to us in the future.

Our primary brands are “Shutterfly,” “Tiny Prints,” “Wedding Paper Divas,” “Treat,” and “ThisLife.” We hold applications and/or registrations for the Shutterfly, Tiny Prints, Wedding Paper Divas, Treat and ThisLife trademarks in our major markets of the United States and Canada, as well as in the European Community. We also hold applications and registrations for the Shutterfly mark in Mexico, Japan and China, and for the Shutterfly and Tiny Prints marks in Australia and New Zealand. We own the domains Shutterfly.com, TinyPrints.com, WeddingPaperDivas.com and Treat.com among others. We have other marks that we use and for which we have applications on file or have obtained registrations in the United States including among others, “Cardworthy,” “Tell Your Story,” “Storyboard,” “Custom Path,” “Bookworthy,” “Smart Autofill,” and “Photoworks.”

Government Regulation

The legal environment of the Internet constantly is evolving in the United States and elsewhere. The manner in which existing laws and regulations will be applied to the Internet in general, and how they will relate to our business in particular, is unclear in many cases. Accordingly, we often cannot be certain how existing laws will apply in the online context, including with respect to such topics as privacy, defamation, pricing, credit card fraud, advertising, taxation, sweepstakes, promotions, content regulation, net neutrality, quality of products, and services and intellectual property ownership and infringement. In particular, legal issues relating to the liability of providers of online services for activities of their users are currently unsettled both within the United States and abroad.

Numerous laws have been adopted at the national and state level in the United States that could have an impact on our business. These laws include the following:

- The CAN-SPAM Act of 2003 and similar laws adopted by a number of states. These laws are intended to regulate unsolicited commercial e-mails, create criminal penalties for unmarked sexually-oriented material and e-mails containing fraudulent headers and control other abusive online marketing practices.

- The Communications Decency Act, which gives statutory protection to online service providers who distribute third-party content.

- The Digital Millennium Copyright Act, which is intended to reduce the liability of online service providers for listing or linking to third-party websites that include materials that infringe copyrights or other rights of others.

- The Children’s Online Privacy Protection Act and the Prosecutorial Remedies and Other Tools to End Exploitation of Children Today Act of 2003, which are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

- Statutes adopted in the State of California and other states, require online services to report certain breaches of the security of personal data, and to report to consumers when their personal data might be disclosed to direct marketers.

- The federal Credit Card Accountability Responsibility and Disclosure Act of 2009 (the “CARD Act”), which was signed into law May 22, 2009, includes new provisions governing the

use of gift cards, including specific disclosure requirements and a prohibition or limitation on the use of expiration dates and fees. A recent statute adopted in the State of New Jersey would enforce escheat of the entire remaining gift card balance when the card is redeemable only for goods and services and would include all gift cards sold after January 1, 2003.

- The Patient Protection and Affordable Care Act (the "Patient Act"), as well as other healthcare reform legislation being considered by Congress and state legislatures. While the significant costs of the recent healthcare legislation enacted will occur after 2013 due to provisions of the legislation being phased in over time, changes to our healthcare costs structure could increase our employee healthcare-related costs.

To resolve some of the remaining legal uncertainty, we expect new U.S. and foreign laws and regulations to be adopted over time that will be directly or indirectly applicable to the Internet and to our activities. In addition, government agencies may begin regulating previously unregulated Internet activities or applying existing laws in new ways to providers of online services. Moreover, the law relating to the liability of providers of online services for activities of their users and business partners is currently unsettled both within the United States and abroad. Any existing or new legislation applicable to us could expose us to government investigations or audits, prosecution for violations of applicable laws and/or substantial liability, including penalties, damages, significant attorneys' fees, expenses necessary to comply with such laws and regulations or the need to modify our business practices. From time to time, claims may be threatened against us for aiding and abetting, defamation, negligence, copyright or trademark infringement, or other theories based on the nature and content of information to which we provide links or that we or others post online. On a more general level, government regulation of the Internet could dampen the growth in the use of the Internet, have the effect of discouraging innovation and investment in Internet-based enterprises or lead to unpredictable litigation.

We post on our websites our privacy policies and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policies, Federal Trade Commission requirements or other privacy-related laws and regulations could result in proceedings that could potentially harm our business, results of operations and financial condition. In this regard, there are a large number of federal and state legislative proposals before the United States Congress and various state legislative bodies regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, such as required use of disclaimers, if adopted, could harm our business through a decrease in user registrations and revenues.

Employees

As of December 31, 2013, we had 1,573 full time employees. Below is a summary of employees by function as of December 31, for each of the last three years:

	2013	2012	2011
Cost of revenue	755	453	422
Technology and development	428	327	264
Sales and marketing	250	213	166
General and administrative	140	114	104
Total	**1,573**	**1,107**	**956**

During the peak holiday season, we hire contract workers on a temporary basis from third-party outsourcing firms. For example, during our peak production period in the fourth quarter of 2013, we used approximately 1,324 temporary workers to assist in our production and fulfillment operations. None of our employees are represented by a labor union or are covered by a collective bargaining agreement. We have never experienced any employment-related work stoppages and consider our employee relations to be good.

Available Information

Our Internet website is located at http://www.shutterflyinc.com. The information on our website is not a part of this annual report on Form 10-K. We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our SEC reports can be accessed through the investor relations section of our Internet website.

The public may also read and copy any materials we file with the Securities and Exchange Commission at the Securities and Exchange Commission's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission also maintains an Internet website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the Securities and Exchange Commission. The Securities and Exchange Commission's Internet website is located at http://www.sec.gov.

ITEM 1A. RISK FACTORS

Our net revenues, operating results and cash requirements are affected by the seasonal nature of our business.

Our business is highly seasonal, with a high proportion of our net revenues, net income and operating cash flows generated during the fourth quarter. For example, we generated more than 50% of our net revenues in the fourth quarter during each of the last three years, and the net income that we generated during the fourth quarter was necessary for us to achieve profitability on an annual basis. In addition, we incur significant additional expenses in the period leading up to the fourth quarter holiday season including expenses related to the hiring and training of temporary workers to meet our seasonal needs, additional inventory and equipment purchases and increased advertising. If we are unable to accurately forecast and respond to consumer demand for our products during the fourth quarter, our financial results, reputation and brands will suffer and the market price of our common stock would likely decline.

We also base our operating expense budgets on expected net revenue trends. A portion of our expenses, such as office, production facility, and various equipment leases and personnel costs, are largely fixed and are based on our expectations of our peak levels of operations. We may be unable to adjust spending quickly enough to offset any unexpected revenue shortfall. Accordingly, any shortfall in net revenues may cause significant variation in operating results in any quarter.

If we are unable to meet our production requirements, our net revenues and results of operations would be harmed.

We believe that we must continue to grow our current production capability to meet our projected net revenue targets. Our capital expenditures were approximately 10%, 9% and 7% of total net revenues for the years ended December 31, 2013, 2012 and 2011, respectively. We anticipate that total capital expenditures for the year ended December 31, 2014 will range from 9.5% to 10.5% of 2014 net revenues. Operational difficulties, such as a significant interruption in the operations of our Fort Mill, South Carolina, Phoenix, Arizona or Elmsford, New York production facilities, could delay production or shipment of our products. Our inability to meet our production requirements could lead to customer dissatisfaction and damage our reputation and brands, which would result in reduced net revenues. Moreover, if the costs of meeting production requirements, including capital expenditures, were to exceed our expectations, our results of operations would be harmed.

In addition, we face significant production risks at peak holiday seasons, including the risk of obtaining sufficient qualified seasonal production personnel. A majority of our workforce during the fourth quarter of 2013 was seasonal, temporary personnel. We have had difficulties in the past finding a sufficient number of qualified seasonal employees, and our failure to obtain qualified seasonal production personnel at any of our production facilities could harm our operations.

Macro economic trends could adversely affect our financial performance.

Our financial performance depends on general economic conditions. The U.S. economy is experiencing a slow economic recovery from a deep recession, concerns about inflation, low consumer confidence, high unemployment rates and other adverse business conditions. Fluctuations in the U.S. economy such as the recent recession could cause, among other adverse business conditions, a prolonged decline in consumer spending and an increase in the cost of labor and materials may harm our operating results. Purchases of our products are often discretionary. If the economic climate does not improve, customers or potential customers could delay, reduce or forego their purchases of our products and services, which could impact our business in a number of ways, including lower prices for our products and services and reduced sales. In addition, adverse economic conditions may lead to price increases by our suppliers or increase our operating expenses due to, among others, higher costs of labor, energy, equipment and facilities. A prolonged and slow economic recovery or a renewed recession may also lead to additional restructuring actions and associated expenses. Due to reduced consumer spending and increased competitive pressures in the current economic environment, we may not be able to pass these increased costs on to our customers. The resulting increased expenses and/or reduced income would negatively impact our operating results. If the economic recovery continues to be slow, or if the economy experiences a prolonged period of decelerating or negative growth, our results of operations may be further harmed.

Competitive pricing pressures, particularly with respect to pricing and shipping, may harm our business and results of operations.

Demand for our products and services is sensitive to price, especially in times of recession, slow economic growth and consumer conservatism. Many external factors, including our production and personnel costs, consumer sentiment and our competitors' pricing and marketing strategies, can significantly impact our pricing strategies. If we fail to meet our customers' price expectations, we could lose customers, which would harm our business and results of operations.

Changes in our pricing strategies have had, and may continue to have, a significant impact on our net revenues and net income. From time to time, we have made changes to our pricing structure, specifically for 4x6 prints, in order to remain competitive. Most of our other products, including photo books, calendars, cards and stationery and other photo merchandise are also offered by our competitors. During the fourth quarter of 2011, many of these competitors discounted those products at an unprecedented level. As a result, we also changed our discounting strategy, which impacted our acquisition of new customers, average order value, net revenues, gross margin, and our adjusted EBITDA and net income profitability measures. If in the future, due to competitor discounting or other marketing strategies, we significantly reduce our prices on our products without a corresponding increase in volume, it would negatively impact our net revenues and could adversely affect our gross margins and overall profitability.

We generate a significant portion of our net revenues from the fees we collect from shipping our products. For example, shipping revenue for the Shutterfly brand website represented approximately 16%, 16% and 15% of our net revenues in 2013, 2012 and 2011, respectively. We offer discounted or free shipping, with a minimum purchase requirement, during promotional periods to attract and retain

customers. If free shipping offers extend beyond a limited number of occasions, are not based upon a minimum purchase requirement or become commonplace, our net revenues and results of operations would be negatively impacted. In addition, we occasionally offer free or discounted products and services to attract and retain customers. In the future, if we increase these offers to respond to actions taken by our competitors, our results of operations may be harmed.

We face intense competition from a range of competitors and may be unsuccessful in competing against current and future competitors.

The digital photography products and services industry is intensely competitive, and we expect competition to increase in the future as current competitors improve their offerings, including developing, acquiring and expanding mobile and cloud-based offerings, and as new participants enter the market or as industry consolidation further develops. Competition may result in pricing pressures, reduced profit margins or loss of market share, any of which could substantially harm our business and results of operations. We face intense competition from a wide range of companies, including the following:

- Online digital photography services companies such as Snapfish, which is a service of Hewlett-Packard, American Greetings' Webshots brand, Vistaprint, SmugMug, and many others;

- Social media companies that host and enable mobile access to and posting of images such as Facebook, Twitter, and Myspace;

- Photo hosting websites that allow users to upload and share images at no cost such as Picasa, Flickr, and Photobucket;

- "Big Box" retailers such as Wal-Mart, Costco, Sam's Club and others that are seeking to offer low cost digital photography products and services. These competitors provide in-store fulfillment and self-service kiosks for printing, and may, among other strategies, offer their customers heavily discounted in-store products and services that compete directly with our offerings;

- Drug stores such as Walgreens, CVS/pharmacy, and others that offer in-store pick-up from their photo website internet orders;

- Mobile digital photography services companies such as Instagram (acquired by Facebook), Woven, and iPhoto;

- Self-publishing companies and services such as Lulu, CafePress, and Zazzle;

- Cloud-based storage services and file-syncing services such as Dropbox, SugarSync, Box, Amazon Cloud Drive, and iCloud;

- Specialized companies in the photo book and stationery business such as Hallmark, Cardstore by American Greetings, Minted, Picaboo, Blurb, Mixbook, MOO, Smilebox, Creative Memories, and Photobook America;

- Photo-related software companies such as Apple, Microsoft, Corel, and FotoFlexer;

- Internet portals and search engines such as Yahoo!, AOL, and Google that offer broad-reaching digital photography and related products and services to their large user bases;

- Home printing service providers such as Hewlett-Packard, Epson, Canon, and Kodak that are seeking to expand their printer and ink businesses by gaining market share in the digital photography marketplace;

- Regional photography companies such as Ritz Camera that have established brands and customer bases in existing photography markets; and

- Camera and photographic supply companies that rent equipment nationwide both online and in brick-and-mortar stores such as LensRentals.com, LensProToGo, Cameralends, AbelCine, and Adorama.

Many of our competitors have significantly longer operating histories, larger and broader customer bases, greater brand and name recognition, greater financial, research and development and distribution resources, and operate in more geographic areas than we do. Well-funded competitors may be better able to withstand economic downturns and periods of slow economic growth and the associated periods of reduced customer spending and increased pricing pressures. The numerous choices for digital photography services can cause confusion for consumers, and may cause them to select a competitor with greater name recognition. Some competitors are able to devote substantially more resources to website and systems development or to investments or partnerships with traditional and online competitors. Well-funded competitors, particularly new entrants, may choose to prioritize growing their market share and brand awareness instead of profitability. Competitors and new entrants in the digital photography products and services industry may develop new products, technologies or capabilities that could render obsolete or less competitive many of our products, services and content. We may be unable to compete successfully against current and future competitors, and competitive pressures could harm our business and prospects.

Our quarterly financial results may fluctuate, which may lead to volatility in our stock price.

Our future revenues and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are difficult for us to predict and control. Factors that could cause our quarterly operating results to fluctuate include:

- general economic conditions, including recession and slow economic growth in the U.S. and worldwide and higher inflation;

- demand for our products and services, including seasonal demand;

- our pricing and marketing strategies and those of our competitors;

- our ability to attract visitors to our websites and convert those visitors into customers;

- our ability to retain customers and encourage repeat purchases;

- the costs of customer acquisition;

- our ability to manage our production and fulfillment operations;

- the costs to produce our prints and photo-based products and merchandise and to provide our services;

- the costs of expanding or enhancing our technology or websites;

- a significant increase in returns and credits, beyond our estimated allowances, for customers who are not satisfied with our products;
- our ability to achieve the expected benefits of strategic partnerships or the loss of any such partnership;
- declines or disruptions to the travel industry;
- variations in weather, particularly heavy rain and snow which tend to depress travel and picture taking;
- the timing of holidays and the duration of the holiday shopping season;
- our ability to address increased shipping delays caused by our third party shippers' inability to handle the ever increasing number of consumers ordering goods online, particularly during the holiday shopping season;
- volatility in our stock price, which may lead to higher stock-based compensation expense;
- consumer preferences for digital photography services;
- improvements to the quality, cost and convenience of desktop printing of digital pictures and products; and
- global and geopolitical events with indirect economic effects such as pandemic disease, hurricane and other natural disasters, war, threat of war or terrorist actions.

Based on the factors cited above, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. It is possible that in one or more future quarters, our operating results may be below the expectations of public market analysts and investors. In that event, the trading price of our common stock may decline.

We have incurred operating losses in the past and may not be able to sustain profitability in the future.

We have periodically experienced operating losses since our inception in 1999. In particular, we make investments in our business that generally result in operating losses in each of the first three quarters of our fiscal year. This typically has enabled us to generate the majority of our net revenue during the fourth quarter and to achieve profitability for the full fiscal year. If we are unable to produce our products and provide our services at commercially reasonable costs, if consumer demand decreases and revenues decline or if our expenses exceed our expectations, we may not be able to achieve, sustain or increase profitability on a quarterly or annual basis.

We face many risks, uncertainties, expenses and difficulties relating to increasing our market share and growing our business.

To address the risks and uncertainties of increasing our market share and growing our business, we must do the following:

- maintain and increase the size of our customer base;

- maintain and enhance our brands;
- enhance and expand our products and services;
- maintain and grow our websites and customer operations;
- successfully execute our business and marketing strategy;
- continue to develop and upgrade our technology and information processing systems;
- continue to enhance our service to meet the needs of a changing market;
- provide a high quality customer experience, including superior customer service and timely product deliveries;
- respond to competitive developments; and
- attract, integrate, retain and motivate qualified personnel.

We may be unable to accomplish one or more of these requirements, which could cause our business to suffer. Accomplishing one or more of these requirements might be very expensive, which could harm our financial results.

If we are not able to reliably meet our data storage and management requirements, our customers may become dissatisfied with our service and our reputation and brands could be harmed.

As a part of our current business model, we offer our customers free unlimited online storage and sharing of photographs and, as a result, must store and manage many petabytes of data. This policy results in immense system requirements and substantial ongoing technological challenges, both of which are expected to continue to increase over time. If we are not able to reliably meet these data storage and management requirements, we could have disruptions in services which could impair customer satisfaction, damage our reputation and brands, and lead to reduced net revenues and increased expenses. Moreover, if the cost of meeting these data storage and management requirements exceeds our expectations, our results of operations would be harmed. For example, after massive flooding shut down major hard disk drive production sites in Thailand, our ability to timely acquire data storage products was adversely affected.

Our data storage system could suffer damage or interruption from human error, fire, flood, power loss, telecommunications failure, break-ins, terrorist attacks, acts of war and similar events. In addition, our primary data storage facilities are located near a major fault line, increasing our susceptibility to the risk that an earthquake could significantly harm our data storage system. If we experience disruption to our redundant systems located at our data storage center, such disruption could result in the deletion or corruption of customers' stored images, which could impair customer satisfaction and lead to decreased revenues.

An increasing number of our customers are using smartphones and other mobile devices to order products and access services. If we are unable to develop mobile applications that are adopted by our customers or if we are unable to generate revenue from our mobile applications, our results of operations and business could be adversely affected.

The number of people who access information about our services and our website through mobile devices, including smartphones and handheld tablets or computers, has increased significantly in the past

year and is expected to increase. As new mobile devices and platforms are released, it is difficult to predict the problems we may encounter in developing products for these alternative devices and platforms, and we may need to devote significant resources to the creation, support, and maintenance of such products. In addition, if we experience difficulties in integrating our mobile applications into mobile devices or if problems arise with our relationships with providers of mobile operating systems or mobile application download stores, such as Apple or Google, if our applications receive unfavorable treatment compared to the promotion and placement of competing applications, such as the order of our products in the Apple AppStore, or if we face increased costs to distribute our mobile applications, our future growth and our results of operations could suffer.

Interruptions to our websites, mobile applications, information technology systems, print production processes or customer service operations could damage our reputation and brands and substantially harm our business and results of operations.

The satisfactory performance, reliability and availability of our websites and mobile applications, information technology systems, printing production processes and customer service operations are critical to our reputation, and our ability to attract and retain customers and maintain adequate customer satisfaction. Any interruptions that result in the unavailability of our websites or mobile applications, reduced order fulfillment performance or the unavailability of our customer service operations could result in negative publicity, damage our reputation and brands and cause our business and results of operations to suffer. This risk is heightened in the fourth quarter, as we experience significantly increased traffic to our websites during the holiday season. Any interruption that occurs during such time would have a disproportionately negative impact than if it occurred during a different quarter. For example, during the fourth quarter of 2013, a software bug caused a minority of orders from our Tiny Prints brand to go unfulfilled. Once the bug was identified and corrected, many of those orders were not received by customers within the expected time frame. As a result, we refunded many orders which reduced net revenue, and we recognized excess costs related to expedited shipping upgrades and increased customer service costs which impacted our gross margin and our brand.

We depend in part on third parties to implement and maintain certain aspects of our communications and printing systems. Therefore many of the causes of system interruptions or interruptions in the production process may be outside of our control. As a result, we may not be able to remedy such interruptions in a timely manner, or at all. Our business interruption insurance policies do not address all potential causes of business interruptions that we may experience, and any proceeds we may receive from these policies in the event of a business interruption may not fully compensate us for the revenues we may lose.

We may have difficulty managing our growth and expanding our operations successfully.

We have website operations, offices and customer support centers in Redwood City, California, Santa Clara, California, and Tempe, Arizona and production facilities in Fort Mill, South Carolina, Phoenix, Arizona and Elmsford, New York and new facilities in Shakopee, Minnesota and Tempe, Arizona and are expected to be operational in 2014 and 2015, respectively. Our growth has placed, and will continue to place, a strain on our administrative and operational infrastructure. Our ability to manage our operations and growth will require us to continue to refine our operational, financial and management controls, human resource policies and reporting systems.

If we are unable to manage future expansion, we may not be able to implement improvements to our controls, policies and systems in an efficient or timely manner and may discover deficiencies in existing systems and controls. Our ability to provide a high-quality customer experience could be compromised,

which would damage our reputation and brands and substantially harm our business and results of operations.

If we are unable to adequately control the costs associated with operating our business, our results of operations will suffer.

The primary costs in operating our business are related to producing and shipping products, acquiring customers, compensating our personnel, acquiring equipment and technology and leasing facilities. If we are unable to keep these costs aligned with the level of revenues that we generate, our results of operations would be harmed. Controlling our business costs is challenging because many of the factors that impact these costs are beyond our control. For example, the costs to produce prints, such as the costs of photographic print paper, could increase due to a shortage of silver or an increase in worldwide energy prices. In addition, we may become subject to increased costs by the third-party shippers that deliver our products to our customers, and we may be unable to pass along any increases in shipping costs to our customers. The costs of online advertising and keyword search could also increase significantly due to increased competition, which would increase our customer acquisition costs.

We may undertake acquisitions to expand our business, which may pose risks to our business and dilute the ownership of our existing stockholders.

A key component of our business strategy includes strengthening our competitive position and refining the customer experience on our websites and mobile applications through internal development. However, from time to time, we may selectively pursue acquisitions of complementary businesses, such as our 2013 acquisition of BorrowLenses LLC, R&R Images, Inc. and MyPublisher, Inc. and our 2012 acquisitions of ThisLife, Inc., Penguin Digital, Inc. and Photoccino, Ltd. and certain assets of Eastman Kodak Company. The identification of suitable acquisition candidates can be time-consuming and expensive, and we may not be able to successfully complete identified acquisitions. Furthermore, even if we successfully complete an acquisition, we may not achieve the anticipated benefits we expect due to a number of factors including the loss of management focus on and the diversion of resources from existing businesses; difficulty retaining key personnel of the acquired company; cultural challenges associated with integrating employees from an acquired company into our organization; difficulty integrating acquired technologies into our existing systems; entry into a business or market with which we have historically had little experience; difficulty integrating data systems; the need to implement or remediate the controls, procedures or policies of the acquired company; and increased risk of litigation. For example, in March 2013, we filed a complaint for damages and injunctive relief, alleging that Eastman Kodak failed to comply with the non-compete provisions of the transfer agreement that it had entered into with us in April 2012. And in October 2013, we acquired BorrowLenses LLC, an online photography and video equipment rental business, which is a new business model for us to integrate and may present different challenges. Failure to achieve the anticipated benefits of such acquisitions or the incurrence of debt, contingent liabilities, amortization expenses, or write-offs of goodwill in connection with such acquisitions could harm our operating results.

In addition, we may issue equity securities to complete an acquisition, which would dilute our existing shareholders' ownership, perhaps significantly depending on the terms of such acquisitions and could adversely affect the price of our common stock. For example, in connection with our 2011 acquisition of Tiny Prints, we issued approximately 5.4 million shares of our common stock as transaction consideration. To finance any future acquisitions, it may also be necessary for us to raise additional funds through public or private debt and equity financings. Additional funds may not be available on terms that are favorable to us, and, in the case of equity financings, would result in dilution to our stockholders. Also, the value of our stock may be insufficient to attract acquisition candidates.

The loss of key personnel and an inability to attract and retain additional personnel could affect our ability to successfully grow our business.

We are highly dependent upon the continued service and performance of our senior management team and key technical, marketing and production personnel. The loss of these key employees, each of whom is "at will" and may terminate his or her employment relationship with us at any time, may significantly delay or prevent the achievement of our business objectives. A lack of management continuity could result in operational and administrative inefficiencies and added costs, which could adversely impact our results of operations and stock price and may make recruiting for future management positions more difficult.

We believe that our future success will also depend in part on our continued ability to identify, hire, train and motivate qualified personnel. We face intense competition for qualified individuals from numerous technology, marketing, financial services, manufacturing and e-commerce companies. In addition, competition for qualified personnel is particularly intense in the San Francisco Bay Area, where our headquarters are located. We may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing operational and managerial requirements, or we may be required to pay increased compensation in order to do so. Our failure to attract and retain qualified personnel could impair our ability to implement our business plan.

If we do not obtain shareholder approval for the issuance of additional shares under our 2006 Equity Incentive Plan, our ability to attract and retain key personnel may be adversely affected.

At the 2013 annual meeting, our stockholders approved an amendment to our 2006 Equity Incentive Plan (the "2006 Plan") to increase the maximum number of shares of our common stock available for issuance under the 2006 Plan such that the number of shares will automatically increase as follows: (i) on January 1, 2014 by 1,200,000 shares and (ii) on January 1, 2015 by 1,200,000 shares. As these increases expire, we will need to seek stockholder approval for the issuance of additional shares under the 2006 Plan, so that we can continue to attract and retain key personnel. Although we obtained approval to increase the authorized number of shares available for issuance under the 2006 Plan at our 2013 annual meeting, there can be no assurances that our stockholders will approve further increases.

In order to attract new personnel, we will need to grant inducement equity awards outside of our 2006 Equity Incentive Plan, which dilutes the ownership of our existing stockholders.

Inducement stock options and restricted stock unit awards granted to new employees upon hire and in connection with mergers and acquisitions in accordance with NASDAQ Listing Rule 5635(c) do not require stockholder approval. In 2007, 2008, 2009 and 2012 the Board approved inducement equity awards to supplement our 2006 Plan for an aggregate of 1,451,673 shares of our common stock. During 2013, we granted inducement equity awards outside of our 2006 Plan to certain new employees that we acquired as part of our acquisition of R&R Images and BorrowLenses for an aggregate of 307,888 shares of our common stock. The issuance of additional shares of common stock may significantly dilute the equity interest of our stockholders and could cause a change in control if a substantial number of shares of common stock are issued, which may affect, among other things, our ability to use our net operating loss carryforwards, if any, and may adversely affect prevailing market prices for our common stock.

If we are unable to attract customers in a cost-effective manner, or if we were to become subject to e-mail blacklisting, traffic to our websites would be reduced and our business and results of operations would be harmed.

Our success depends on our ability to attract customers in a cost-effective manner. We rely on a variety of methods to bring visitors to our websites and promote our products, including paying fees to third parties who drive new customers to our websites, purchasing search results from online search engines, e-mail and direct mail. We pay providers of online services, search engines, directories and other websites and e-commerce businesses to provide content, advertising banners and other links that direct customers to our websites. We also use e-mail and direct mail to offer free products and services to attract customers, and we offer substantial pricing discounts to encourage repeat purchases. Our methods of attracting customers, including acquiring customer lists from third parties, such as our acquisitions of customer lists from Kodak, Fuji, American Greetings, Sony and Yahoo!, can involve substantial costs, regardless of whether we acquire new customers. Even if we are successful in acquiring and retaining customers, the cost involved in these efforts impacts our results of operations. Customer lists are typically recorded as intangible assets and may be subject to impairment charges if the fair value of that list exceeds its carrying value. These potential impairment charges could harm our results from operations. If we are unable to enhance or maintain the methods we use to reach consumers, if the costs of attracting customers using these methods significantly increase, or if we are unable to develop new cost-effective means to obtain customers, our ability to attract new customers would be harmed, traffic to our websites would be reduced and our business and results of operations would be harmed.

In addition, various private entities attempt to regulate the use of e-mail for commercial solicitation. These entities often advocate standards of conduct or practice that significantly exceed current legal requirements and classify certain e-mail solicitations that comply with current legal requirements as unsolicited bulk e-mails, or "spam." Some of these entities maintain blacklists of companies and individuals, and the websites, Internet service providers and Internet protocol addresses associated with those entities or individuals that do not adhere to what the blacklisting entity believes are appropriate standards of conduct or practices for commercial e-mail solicitations. If a company's Internet protocol addresses are listed by a blacklisting entity, e-mails sent from those addresses may be blocked if they are sent to any Internet domain or Internet address that subscribes to the blacklisting entity's service or purchases its blacklist. From time to time we are blacklisted, sometimes without our knowledge, which could impair our ability to market our products and services, communicate with our customers and otherwise operate our business. In addition, we have noted that unauthorized "spammers" utilize our domain name to solicit spam, which increases the frequency and likelihood that we may be blacklisted.

Our business could be negatively affected by changes in search engine algorithms and dynamics, or search engine disintermediation.

We rely on Internet search engines such as Google, Bing and Yahoo!, including through the purchase of keywords related to photo-based products, to generate traffic to our websites. We obtain a significant amount of traffic via search engines and, therefore, utilize techniques such as search engine optimization and search engine marketing to improve our placement in relevant search queries. Search engines, including Google, Bing and Yahoo!, frequently update and change the logic that determines the placement and display of results of a user's search, such that the purchased or algorithmic placement of links to our websites can be negatively affected. Moreover, a search engine could, for competitive or other purposes, alter its search algorithms or results causing our websites to place lower in search query results. If a major search engine changes its algorithms in a manner that negatively affects our paid or unpaid search ranking, or if competitive dynamics impact the effectiveness of search engine optimization or search engine marketing in a negative manner, our business and financial performance would be adversely affected, potentially to a material extent.

We may not succeed in promoting, strengthening and continuing to establish the Shutterfly, Tiny Prints, Wedding Paper Divas and Treat brands, which would prevent us from acquiring new customers and increasing revenues.

A component of our business strategy is the continued promotion and strengthening of the Shutterfly, Tiny Prints, Wedding Paper Divas and Treat brands. Due to the competitive nature of the digital photography products and services markets, if we are unable to successfully promote our brands, we may fail to attract new customers, increase the engagement of existing customers with our brands or substantially increase our net revenues. Customer awareness and the perceived value of our brands will depend largely on the success of our marketing efforts and our ability to provide a consistent, high-quality customer experience. To promote our brands, we have incurred, and will continue to incur, substantial expense related to advertising and other marketing efforts.

Our ability to provide a high-quality customer experience also depends, in large part, on external factors over which we may have little or no control, including the reliability and performance of our suppliers and third-party Internet and communication infrastructure providers. For example, some of our products, such as select photo-based merchandise, are produced and shipped to customers by our third-party vendors, and we rely on these vendors to properly inspect and ship these products. In addition, we rely on third-party shippers, including the U.S. Postal Service, United Parcel Service and FedEx, to deliver our products to customers. Strikes, furloughs, reduced operations, increased shipping delays particularly during the holiday shopping season, or other service interruptions affecting these shippers could impair our ability to deliver merchandise on a timely basis. Our products are also subject to damage during delivery and handling by our third-party shippers. Our failure to provide customers with high-quality products in a timely manner for any reason could substantially harm our reputation and our efforts to develop trusted brands. The failure of our brand promotion activities could adversely affect our ability to attract new customers and maintain customer relationships, which would substantially harm our business and results of operations.

If we are unable to develop, market and sell new products and services that address additional market opportunities, our results of operations may suffer. In addition, we may need to expand beyond our current customer demographic to grow our business.

Although historically we have focused our business on consumer markets for silver halide prints, such as 4x6 prints, and photo-based products, such as photo books, stationery cards and calendars, we continually evaluate the demand for new products and services and the need to address these trends. In addition, we believe we may need to address additional markets and expand our customer demographic in order to further grow our business. We may not successfully expand our existing services or create new products and services, address new market segments or develop a significantly broader customer base. Any failure to address additional market opportunities could result in loss of market share, which would harm our business, financial condition and results of operations.

If we do not successfully develop and maintain a relevant multichannel experience for our customers, our results of operations may suffer.

Our customers are increasingly using computers, tablets, mobile phones, and other devices to produce photos and photo-based products online. As part of our multichannel strategy, we are making technology investments in our websites and recently launched a mobile application for mobile phones and other electronic devices. If we are unable to make, improve, or develop relevant customer-facing technology in a timely manner, our ability to compete could be adversely affected and may result in the loss of market share, which could harm our results of operations. In addition, if our technology systems do not function as designed, we may experience a loss of confidence, data security breaches or lost sales, which could adversely affect our reputation and results of operations.

If the facility where our computer and communications hardware is located fails or if any of our production facilities fail, our business and results of operations would be harmed.

Our ability to successfully receive and fulfill orders and to provide high-quality customer service depends in part on the efficient and uninterrupted operation of our computer and communications systems. Currently, all of the computer hardware necessary to operate our websites is located at one third-party hosting facility in Santa Clara, California. During 2014, we will be migrating the computer hardware to a new location in Las Vegas, Nevada, and there could be significant disruptions caused by such move. We also have computer hardware located in our production facilities in Fort Mill, South Carolina, Phoenix, Arizona, and Elmsford, New York. Our systems and operations could suffer damage or interruption from human error, fire, flood, power loss, insufficient power availability, telecommunications failure, break-ins, terrorist attacks, acts of war and similar events. In addition, Santa Clara is located near a major fault line increasing our susceptibility to the risk that an earthquake could significantly harm the operations of these facilities. We maintain business interruption insurance; however, this insurance may be insufficient to compensate us for losses that may occur, particularly from interruption due to an earthquake which is not covered under our current policy. We do not presently have redundant systems in multiple locations. In addition, the impact of any of these disasters on our business may be exacerbated by the fact that we are still in the process of developing our formal disaster recovery plan and we do not have a final plan in place.

Capacity constraints and system failures could prevent access to our websites, which could harm our reputation and negatively affect our net revenues.

Our business requires that we have adequate capacity in our computer systems to cope with the high volume of visits to our websites. As our operations grow in size and scope, we continually need to improve and upgrade our computer systems and network infrastructure to ensure reliable access to our websites, in order to offer customers enhanced and new products, services, capacity, features and functionality. The expansion of our systems and infrastructure may require us to commit substantial financial, operational and technical resources before the volume of our business increases, with no assurance that our net revenues will increase.

Our ability to provide high-quality products and service depends on the efficient and uninterrupted operation of our computer and communications systems. If our systems cannot be expanded in a timely manner to cope with increased website traffic, we could experience disruptions in service, slower response times, lower customer satisfaction, and delays in the introduction of new products and services. Any of these problems could harm our reputation and cause our net revenues to decline.

Our technology, infrastructure and processes may contain undetected errors or design faults that could result in decreased production, limited capacity or reduced demand.

Our technology, infrastructure and processes may contain undetected errors or design faults. These errors or design faults may cause our websites and mobile applications to fail and result in loss of, or delay in, market acceptance of our products and services. If we experience a delay in a website or mobile application release that results in customer dissatisfaction during the period required to correct errors and design faults, we would lose revenue. In the future, we may encounter scalability limitations, in current or future technology releases, or delays in the commercial release of any future version of our technology, infrastructure and processes that could seriously harm our business.

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

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

We currently outsource some of our off-line and on-line marketing, our customer service activities and some of our production of print and photo-based products to third parties, which exposes us to risks if these parties fail to perform under our agreements with them.

We currently outsource some of our off-line and on-line marketing, our customer service activities and the production of some of our print and photo-based products to third parties. If these parties fail to perform in accordance with the terms of our agreements and if we are unable to secure another outsource partner in a timely manner, we would likely fail to meet customer expectations, which could result in negative publicity, damage our reputation and brands and harm our business and results of operations.

Our net revenues and results of operations are affected by the level of vacation and other travel by our customers, and any declines or disruptions in the travel industry could harm our business.

Because vacation and other travel is one of the primary occasions in which our customers utilize their digital cameras, our net revenues and results of operations are affected by the level of vacation and other travel by our customers. Accordingly, downturns or weaknesses in the travel industry could harm our business. Travel expenditures are sensitive to business and personal discretionary spending levels and tend to decline during general economic slowdowns such as those experienced in the United States and worldwide. Events or weaknesses that could negatively affect the travel industry include price escalation in the airline industry or other travel-related industries, airline or other travel related strikes, work stoppages or labor unrest, safety concerns, including terrorist activities, political instability or regional hostility, pandemic disease (including the influenza virus), inclement weather, airline bankruptcies or liquidations, increases in fuel prices, and the imposition of taxes or surcharges by regulatory authorities. Any decrease in vacation or travel could harm our net revenues and results of operations.

Failure to adequately protect our intellectual property could substantially harm our business and results of operations.

We rely on a combination of patent, trademark, trade secret and copyright law and contractual restrictions to protect our intellectual property. These protective measures afford only limited protection. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our website features and functionalities or to obtain and use information that we consider proprietary, such as the technology used to operate our websites, our production operations and our trademarks.

As of December 31, 2013, Shutterfly had 65 patents issued, and had more than 40 patent applications pending in the United States. We intend to pursue corresponding patent coverage in other countries to the extent we believe such coverage is appropriate and cost efficient. We cannot ensure that any of our pending applications will be granted. In addition, third parties have in the past and could in the future bring infringement, invalidity, co-inventorship or similar claims with respect to any of our currently issued patents or any patents that may be issued to us in the future. Any such claims, whether or not successful, could be extremely costly to defend, divert management's time and attention, damage our reputation and brands and substantially harm our business and results of operations.

Our primary brands are "Shutterfly," "Tiny Prints," "Wedding Paper Divas," "Treat," and "ThisLife." We hold applications and/or registrations for the Shutterfly, Tiny Prints, Wedding Paper Divas, Treat and ThisLife trademarks in our major markets of the United States and Canada as well as in the European Community. We also hold applications and registrations for the Shutterfly mark in Mexico, Japan and China, and for the Shutterfly and Tiny Prints marks in Australia and New Zealand. Our marks are critical components of our marketing programs. If we lose the ability to use these marks in any particular market, we could be forced to either incur significant additional marketing expenses within that market, or elect not to sell products in that market.

From time to time, third parties have adopted names similar to ours, have applied to register trademarks similar to ours, and we believe have infringed or misappropriated our intellectual property rights and impeded our ability to build brand identity and possibly leading to customer confusion. In addition, we have been and may continue to be subject to potential trade name or trademark infringement claims brought by owners of marks that are similar to Shutterfly, Tiny Prints, Wedding Paper Divas, Treat, ThisLife or one of our other marks.

We respond on a case-by-case basis and where appropriate may send cease and desist letters or commence opposition actions and litigation. However, we cannot ensure that the steps we have taken to protect our intellectual property rights are adequate, that our intellectual property rights can be successfully defended and asserted in the future or that third parties will not infringe upon or misappropriate any such rights. In addition, our trademark rights and related registrations may be challenged in the future and could be canceled or narrowed. Failure to protect our trademark rights could prevent us in the future from challenging third parties who use names and logos similar to our trademarks, which may in turn cause consumer confusion or negatively affect consumers' perception of our brands, products, and services. Any claims or consumer confusion related to our marks could damage our reputation and brands and substantially harm our business and results of operations.

If we become involved in intellectual property litigation or other proceedings related to a determination of rights, we could incur substantial costs, expenses or liability, lose our exclusive rights or be required to stop certain of our business activities.

From time to time, we have received, and likely will continue to receive, communications from third parties inviting us to license their patents or accusing us of infringement. There can be no assurance that a third party will not take further action, such as filing a patent infringement lawsuit, including a request for injunctive relief to bar the manufacture and sale of our products and services in the United States or elsewhere. We may also choose to defend ourselves by initiating litigation or administrative proceedings to clarify or seek a declaration of our rights. Additionally, from time to time, we have to defend against infringement of our intellectual property by bringing suit against other parties. As competition in our market grows, the possibility of patent infringement claims against us or litigation we will initiate increases.

The cost to us of any litigation or other proceeding relating to intellectual property rights, whether or not initiated by us and even if resolved in our favor, could be substantial, and the litigation would divert our management's efforts from growing our business. Some of our competitors may be able to sustain the costs of complex intellectual property litigation more effectively than we can because they have substantially greater resources. Uncertainties resulting from the initiation and continuation of any litigation could limit our ability to continue our operations.

Alternatively, we may be required to, or decide to, enter into a license with a third party. Any future license required under any other party's patents may not be made available on commercially acceptable terms, if at all. In addition, such licenses are likely to be non-exclusive and, therefore, our competitors may have access to the same technology licensed to us. If we fail to obtain a required license and are unable to design around a patent, we may be unable to effectively conduct certain of our business activities, which could limit our ability to generate revenues and harm our results of operations and possibly prevent us from generating revenues sufficient to sustain our operations.

Various governmental legal proceedings, investigations or audits may adversely affect our business and financial performance.

We may be subject to investigations or audits by governmental authorities and regulatory agencies, which can occur in the ordinary course of business or which can result from increased scrutiny from a particular agency towards an industry, country or practice. For example, we are currently under audit by the Internal Revenue Service (IRS) for the tax year ended December 31, 2010 and California Franchise Tax Board (FTB) for the tax years ended December 31, 2010 and 2011. The resolution of such legal proceedings, investigations or audits could require us to pay substantial amounts of money or take actions that adversely affect our operations. In addition, defending against these claims may involve significant time and expense. Given the visibility of our brands, we may regularly be involved in legal proceedings, government investigations or audits that could adversely affect our business and financial performance.

We may be subject to past or future liabilities for collection of sales and use taxes, and the payment of corporate level taxes.

Our policies concerning the collection of sales and use taxes and the payment of certain corporate level taxes have been based upon decisions of the U.S. Supreme Court that determine when a taxpayer is deemed to have nexus with a state sufficient to impose tax obligations under the Commerce Clause of the U.S. Constitution. Those Supreme Court decisions require that the taxpayer be physically present before a state can require the collection of sales and use taxes. States are currently attempting to expand the definition of what constitutes physical presence for sales and use taxes. At the same time, the standard governing the imposition of other taxes, for instance, corporate income taxes, is less established and a number of state courts have concluded that the Commerce Clause definition of nexus should be expanded to include either "physical" or "economic" presence (essentially marketing activities) which is a broader definition than is used for sales and use tax.

We collect sales and use taxes in jurisdictions where we have employees and/or property and in other states where we have implemented joint sales efforts with Target Corporation and other retailers.

While we believe the U.S. Supreme Court decisions support our policies concerning the collection and payment of taxes, tax authorities could disagree with our interpretations. If sustained, those authorities might seek to impose past as well as future liability for taxes and/or penalties. Such impositions could also impose significant administrative burdens and decrease our future sales. Moreover, the U.S. Congress has

been considering various initiatives that could limit or supersede the U.S. Supreme Court's position regarding sales and use taxes.

Our effective tax rate may be subject to fluctuation from federal and state audits, and stock-based compensation activity.

Future tax audits by taxing agencies for the open tax years could lead to fluctuations in our effective tax rate because the taxing authority may disagree with certain assumptions we have made regarding appropriate credits and deductions in filing our tax returns.

Under current stock option tax regulations, our effective tax rate is subject to fluctuations as a result of stock-based compensation activity. This includes items such as shortfalls associated with the vesting of restricted stock units and restricted stock awards, disqualifying dispositions when employees exercise and sell their incentive stock options within a two year period, and cancellation of vested non-qualified stock options.

Government regulation of the Internet and e-commerce is evolving, and unfavorable changes or failure by us to comply with these regulations could substantially harm our business and results of operations.

We are subject to general business regulations and laws as well as regulations and laws specifically governing the Internet and e-commerce. Existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, restrictions on imports and exports, customs, tariffs, user privacy, data protection, pricing, content, copyrights, distribution, electronic contracts and other communications, consumer protection, the provision of online payment services, broadband residential Internet access and the characteristics and quality of products and services. It is not clear how existing laws governing issues such as property use and ownership, sales and other taxes, fraud, libel and personal privacy apply to the Internet and e-commerce as the vast majority of these laws were adopted prior to the advent of the Internet and do not contemplate or address the unique issues raised by the Internet or e-commerce. Those laws that do reference the Internet are only beginning to be interpreted by the courts and their applicability and reach are therefore uncertain. For example:

- The Digital Millennium Copyright Act ("DMCA") is intended, in part, to limit the liability of eligible online service providers for including (or for listing or linking to third-party websites that include) materials that infringe copyrights or other rights of others. Portions of the Communications Decency Act ("CDA") are intended to provide statutory protections to online service providers who distribute third-party content. We rely on the protections provided by both the DMCA and CDA in conducting our business. Any changes in these laws or judicial interpretations narrowing their protections will subject us to greater risk of liability and may increase our costs of compliance with these regulations or limit our ability to operate certain lines of business.

- The Children's Online Protection Act and the Children's Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

- The Credit Card Accountability, Responsibility and Disclosure Act ("CARD Act") is intended to protect consumers from unfair credit card billing practices and adds new regulations on the

use of gift cards, limiting our ability to expire them. In addition, several states are also attempting to pass new laws regulating the use of gift cards and amending state escheatment laws to try and obtain unused gift card balances.

- The Restore Online Shoppers' Confidence Act ("ROSCA") prohibits and prevents Internet-based post-transaction third party sales and imposes specific requirements on negative option features.

The costs of compliance with these regulations may increase in the future as a result of changes in the regulations or the interpretation of them. Further, any failures on our part to comply with these regulations may subject us to significant liabilities. Those current and future laws and regulations or unfavorable resolution of these issues may substantially harm our business and results of operations.

Legislation regarding copyright protection or content interdiction could impose complex and costly constraints on our business model.

Because of our focus on automation and high volumes, our operations do not involve, for the vast majority of our sales, any human-based review of content. Although our websites' terms of use specifically require customers to represent that they have the right and authority to reproduce the content they provide and that the content is in full compliance with all relevant laws and regulations, we do not have the ability to determine the accuracy of these representations on a case-by-case basis. There is a risk that a customer may supply an image or other content that is the property of another party used without permission, that infringes the copyright or trademark of another party, or that would be considered to be defamatory, pornographic, hateful, racist, scandalous, obscene or otherwise offensive, objectionable or illegal under the laws or court decisions of the jurisdiction where that customer lives. There is, therefore, a risk that customers may intentionally or inadvertently order and receive products from us that are in violation of the rights of another party or a law or regulation of a particular jurisdiction. If we should become legally obligated in the future to perform manual screening and review for all orders destined for a jurisdiction, we will encounter increased production costs or may cease accepting orders for shipment to that jurisdiction. That could substantially harm our business and results of operations.

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

We regularly offer free products and free shipping as an inducement for customers to try our products. Although we believe that we conspicuously and clearly communicate all details and conditions of these offers — for example, that customers are required to pay shipping, handling and/or processing charges to take advantage of the free product offer — we may be subject to claims from individuals or governmental regulators that our free offers are misleading or do not comply with applicable legislation. These claims may be expensive to defend and could divert management's time and attention. If we become subject to such claims in the future, or are required or elect to curtail or eliminate our use of free offers, our results of operations may be harmed.

Any failure by us to protect the confidential information of our customers and networks against security breaches and the risks associated with credit card fraud could damage our reputation and brands and substantially harm our business and results of operations.

A significant prerequisite to online commerce and communications is the secure transmission of confidential information over public networks. Our failure to prevent security breaches could damage our reputation and brands and substantially harm our business and results of operations. For example, a majority of our sales are billed to our customers' credit card accounts directly, orders are shipped to a

customer's address, and customers log on using their e-mail address. We rely on encryption and authentication technology licensed from third parties to effect the secure transmission of confidential information, including credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology used by us to protect customer transaction data. In addition, any party who is able to illicitly obtain a user's password could access the user's transaction data, personal information or stored images. Any compromise of our security could damage our reputation and brands and expose us to a risk of loss or litigation and possible liability, which would substantially harm our business and results of operations. In addition, anyone who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may need to devote significant resources to protect against security breaches or to address problems caused by breaches.

In addition, contractors that we hire as well as other employees have access to confidential information, including credit card data. Although we take steps to limit this access, this data could be compromised by these contractors or other employee personnel. Under current credit card practices, we are liable for fraudulent credit card transactions because we do not obtain a cardholder's signature. We do not currently carry insurance against this risk. To date, we have experienced minimal losses from credit card fraud, but we continue to face the risk of significant losses from this type of fraud. Our failure to adequately control fraudulent credit card transactions and use of confidential information could damage our reputation and brands and substantially harm our business and results of operations.

The inability to acquire or maintain domain names for our brands could substantially harm our business and results of operations.

We currently are the registrant of the Internet domain name for Shutterfly.com, TinyPrints.com, WeddingPaperDivas.com, Treat.com, MyPublisher.com, and BorrowLenses.com as well as various related domain names. Domain names generally are regulated by Internet regulatory bodies and are controlled also by trademark and other related laws. The regulations governing domain names could change in ways that block or interfere with our ability to use relevant domains. Also, we might not be able to prevent third parties from registering or retaining domain names that interfere with our consumer communications, or infringe or otherwise decrease the value of our trademarks and other proprietary rights. Recently, regulatory bodies have approved expanded generic top-level domain names, which involves substantial costs and may lead to an increase in cybersquatting. Regulatory bodies also may establish additional generic or country-code top-level domains or modify the requirements for holding domain names. As a result, we might not be able to acquire or maintain the domain names that utilize the name Shutterfly, TinyPrints, WeddingPaperDivas, Treat, MyPublisher, or BorrowLenses in all of the countries in which we currently or intend to conduct business. This could substantially harm our business and results of operations.

Changes in regulations or user concerns regarding privacy and protection of user data could harm our business.

Federal, state and international laws and regulations may govern the collection, use, sharing and security of data that we receive from our customers. In addition, we have and post on our websites our own privacy policies and practices concerning the collection, use and disclosure of customer data. Any failure, or perceived failure, by us to comply with our posted privacy policies or with any data-related consent orders, Federal Trade Commission requirements or other federal, state or international privacy-related laws and regulations could result in proceedings or actions against us by governmental entities or others, which could potentially harm our business. Further, failure or perceived failure to comply with our policies or applicable requirements related to the collection, use or security of personal information or other privacy-related matters could damage our reputation and result in a loss of customers.

International expansion will require management attention and resources and may be unsuccessful, which could harm our future business development and existing domestic operations.

To date, we have conducted limited international operations, but we intend to expand into international markets in order to grow our business. These expansion plans will require significant management attention and resources and may be unsuccessful. We have limited experience adapting our products to conform to local cultures, standards and policies. We may have to compete with established local or regional companies which understand the local market better than we do. In addition, to achieve satisfactory performance for consumers in international locations it may be necessary to locate physical facilities, such as production facilities, in the foreign market. We do not have experience establishing, acquiring or operating such facilities overseas. We may not be successful in expanding into any international markets or in generating revenues from foreign operations. In addition, different privacy, censorship and liability standards and regulations and different intellectual property laws in foreign countries may cause our business to be harmed.

The success of our business depends on our ability to adapt to the continued evolution of digital photography.

The digital photography market is rapidly evolving, characterized by changing technologies, intense price competition, additional competitors, evolving industry standards, frequent new service announcements and changing consumer demands and behaviors. To the extent that consumer adoption of digital photography does not continue to grow as expected, our revenue growth would likely suffer. Moreover, we face significant risks that, if the market for digital photography evolves in ways that we are not able to address due to changing technologies or consumer behaviors, pricing pressures, or otherwise, our current products and services may become less attractive, which would result in the loss of customers, as well as lower net revenues and/or increased expenses.

Purchasers of digital photography products and services may not choose to shop online, which would harm our net revenues and results of operations.

The online market for digital photography products and services is less developed than the online market for other consumer products. If this market does not gain widespread acceptance, our business may suffer. Our success will depend in part on our ability to attract customers who historically have used traditional retail photography services or who have produced photographs and other products using self-service alternatives, such as printing at home. Furthermore, we may have to incur significantly higher and more sustained advertising and promotional expenditures or reduce the prices of our products and services in order to attract additional online consumers to our websites and convert them into purchasing customers. Specific factors that could prevent prospective customers from purchasing from us include:

- the inability to physically handle and examine product samples;
- delivery time associated with Internet orders;
- concerns about the security of online transactions and the privacy of personal information;
- delayed shipments or shipments of incorrect or damaged products; and
- inconvenience associated with returning or exchanging purchased items.

If purchasers of digital photography products and services do not choose to shop online, our net revenues and results of operations would be harmed.

If affordable broadband access does not become widely available to consumers, our revenue growth will likely suffer.

Because our business currently involves consumers uploading and downloading large data files, we are highly dependent upon the availability of affordable broadband access to consumers. Many areas of the country still do not have broadband access, and broadband access may be too expensive for many potential customers. To the extent that broadband access is not available or not adopted by consumers due to cost, our revenue growth would likely suffer.

The third party software systems that we utilize to assist us in the calculation and reporting of financial data may contain errors that we may not identify in a timely manner.

We use numerous third party licensed software packages, most notably our equity software and our enterprise resource planning software, which are complex and fully integrated into our financial reporting. Such third party software may contain errors that we may not identify in a timely manner. If those errors are not identified and addressed timely, our financial reporting may not be in compliance with generally accepted accounting principles.

If our internal controls are not effective, there may be errors in our financial information that could require a restatement or delay our SEC filings, and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

It is possible that we may discover significant deficiencies or material weaknesses in our internal control over financial reporting in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could cause us to fail to meet our periodic reporting obligations, or result in material misstatements in our financial information. Any such delays or restatements could cause investors to lose confidence in our reported financial information and lead to a decline in our stock price.

Maintaining and improving our financial controls and the requirements of being a public company may strain our resources, divert management's attention and affect our ability to attract and retain qualified board members.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002 and the rules and regulations of The NASDAQ Stock Market. In addition, the recently passed Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 contains various provisions applicable to the corporate governance functions of public companies. Additional or new regulatory requirements may be adopted in the future. The requirements of existing and potential future rules and regulations will likely continue to increase our legal, accounting and financial compliance costs, make some activities more difficult, time-consuming or costly and may also place undue strain on our personnel, systems and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and effective internal control over financial reporting. Significant resources and management oversight are required to design, document, test, implement and monitor internal control over relevant processes and to remediate any deficiencies. As a result, management's attention may be diverted from other business concerns, which could harm our business, financial condition and results of operations. These efforts also involve substantial accounting related costs. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on The NASDAQ Global Select Market.

Under the Sarbanes-Oxley Act and the rules and regulations of The NASDAQ Stock Market, we are required to maintain a board of directors with a majority of independent directors. These rules and regulations may make it more difficult and more expensive for us to maintain directors' and officers' liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate directors' and officers' insurance, our ability to recruit and retain qualified directors and officers, especially those directors who may be considered independent for purposes of NASDAQ rules, will be significantly curtailed.

Risks Related to Our Convertible Senior Notes

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In the future, we may sell additional shares of our common stock to raise capital. In addition, a substantial number of shares of our common stock is reserved for issuance upon the exercise of stock options, the vesting of restricted stock units and other equity awards pursuant to our employee benefit plans, upon conversion of the notes, and in relation to the convertible note hedge and warrant transactions

entered into in connection with the pricing of the notes. We cannot predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the trading price of the notes and the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

Repurchases by us of our common stock may affect the value of the notes and our common stock.

We used $30.0 million of the net proceeds from the notes offering to repurchase shares of our common stock from purchasers of notes in the offering in privately negotiated transactions effected through Morgan Stanley & Co. LLC as our agent. We may from time to time repurchase additional shares of our common stock pursuant to our stock repurchase program. These repurchases could increase, or prevent a decrease in, the market price of our common stock or the notes.

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

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

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

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

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

Under the notes, a converting holder will be exposed to fluctuations in the value of our common stock during the period from the date such holder surrenders notes for conversion until the date we settle our conversion obligation. Upon conversion of the notes, we have the option to pay or deliver, as the case may be, cash, shares of our common stock, or a combination of cash and shares of our common stock. If we elect to satisfy our conversion obligation in cash or a combination of cash and shares of our common stock,

the amount of consideration that holders will receive upon conversion of their notes will be determined by reference to the volume weighted average prices of our common stock for each trading day in a 30 trading-day observation period. Accordingly, if the price of our common stock decreases during such observation period, the amount and/or value of consideration holders receive will be adversely affected. In addition, if the market price of our common stock at the end of such period is below the average of the volume weighted average price of our common stock during such period, the value of any shares of our common stock that holders will receive in satisfaction of our conversion obligation will be less than the value used to determine the number of shares that holders will receive.

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

The notes are not protected by restrictive covenants.

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

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

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

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

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

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

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

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

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

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

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

An active trading market may not develop for the notes.

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

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

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

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

The conversion rate of the notes will be adjusted in certain circumstances. Under Section 305(c) of the Internal Revenue Code of 1986, or the Code, adjustments (or failures to make adjustments) that have the effect of increasing the holders' proportionate interest in our assets or earnings may in some circumstances result in a deemed distribution to the holders. Certain of the conversion rate adjustments with respect to the notes (including, without limitation, adjustments in respect of taxable dividends to holders of our common stock) will result in deemed distributions to the holders of notes even though they have not received any cash or property as a result of such adjustments. In addition, an adjustment to the conversion rate in connection with a make-whole fundamental change may be treated as a deemed distribution. Any deemed distributions will be taxable as a dividend, return of capital, or capital gain. If holders are a "non-U.S. holder" under the Code any deemed dividend may be subject to U.S. withholding tax at a 30% rate or such lower rate as may be specified by an applicable tax treaty, which may be set off against subsequent payments on the notes (or in certain circumstances, on the common stock). Under proposed regulations relating to certain "dividend equivalent" payments, an adjustment to the conversion rate of the notes as a result of a dividend on our common stock may be subject to withholding tax at a different time or in a different amount than the withholding tax otherwise imposed on dividends and constructive dividends.

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

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

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

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

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

We are subject to counterparty risk with respect to the convertible note hedge transactions.

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

Risks Related to Our Common Stock

Our stock price may be volatile or may decline regardless of our operating performance.

The market price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control. In particular, the stock market as a whole recently has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to those companies' operating performance. Factors that could cause our stock price to fluctuate include:

- slow economic growth, and market conditions or trends in our industry or the macro-economy as a whole;
- price and volume fluctuations in the overall stock market;
- changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular;

- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- changes in financial estimates by any securities analysts who follow our company, our failure to meet these estimates or failure of those analysts to initiate or maintain coverage of our stock;
- ratings downgrades by any securities analysts who follow our company;
- the public's response to our press releases or other public announcements, including our filings with the SEC;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- introduction of technologies or product enhancements that reduce the need for our products;
- the loss of key personnel;
- lawsuits threatened or filed against us;
- future sales of our common stock by our executive officers, directors and significant stockholders; and
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

Provisions of our restated certificate of incorporation and restated bylaws and Delaware law may deter third parties from acquiring us.

Our restated certificate of incorporation and restated bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

- our board is classified into three classes of directors, each with staggered three-year terms;
- only our chairman, our chief executive officer, our president, or a majority of our board of directors is authorized to call a special meeting of stockholders;
- our stockholders may take action only at a meeting of stockholders and not by written consent;
- vacancies on our board of directors may be filled only by our board of directors and not by stockholders;
- our certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for stockholders to elect directors of their choosing and to cause us to take other corporate actions they desire.

In addition, we are subject to Section 203 of the Delaware General Corporation Law, which, subject to some exceptions, prohibits "business combinations" between a Delaware corporation and an "interested stockholder," which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock, for a three-year period following the date that the stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control that our stockholders might consider to be in their best interests.

We do not intend to pay dividends on our common stock for the foreseeable future.

We have never declared or paid cash dividends on our common stock. In addition, we must comply with the covenants in our credit facilities if we want to pay cash dividends. We currently intend to retain our future earnings, if any, to finance the further development and expansion of our business and do not intend to pay cash dividends in the foreseeable future. Any future determination to pay dividends will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, capital requirements, restrictions contained in current or future financing instruments and such other factors as our board of directors deems relevant.

ITEM 1B. *UNRESOLVED STAFF COMMENTS.*

Not applicable.

ITEM 2. *PROPERTIES.*

The table below includes material property leases, including both operating and build-to-suit leases. During 2013, we entered into a lease for office space in Santa Clara, California and for manufacturing facilities in Shakopee, Minnesota and Tempe, Arizona which are expected to be operational in 2014 and 2015, respectively.

We believe that our existing facilities are adequate to meet our current needs.

Location	Principal Use	Square Footage	Lease Term
Redwood City, California(1)	Corporate headquarters	100,000	2017
Santa Clara, California(2)	Office space	53,700	2017
Phoenix, Arizona(3)	Manufacturing facility	101,200	2016
Fort Mill, South Carolina(4)	Manufacturing and customer service facility	300,000	2023
Elmsford, New York(5)	Manufacturing facility (MyPublisher acquisition)	40,000	2023
Shakopee, Minnesota(6)	Manufacturing facility	217,000	2024
Phoenix, Arizona	Manufacturing facility (R&R acquisition)	29,300	2017
Tempe, Arizona(7)	Manufacturing and customer service facility	217,000	2025

(1) We have an option to extend the lease for two additional periods of three years each. The lease also provided for a $2.1 million tenant improvement reimbursement allowance which was fully utilized as of December 31, 2011.

(2) We have an option to extend the lease for one additional period of three years.

(3) We have an option to extend the lease for three additional periods of five years each, and a right of first offer to lease space in adjacent buildings.

(4) We have the option to expand the facility by an additional 100,000 square feet as well as an option to extend the lease for one additional period of five years.

(5) We have an option to extend the lease for two additional periods of five years each.

(6) This facility is expected to become operational during 2014. In order for the facility to meet our operating specifications, we and the landlord are making structural changes as part of the uplift of the building. We have an option to extend the lease for three additional periods of five years.

(7) This facility is expected to become operational during 2015. In order for the facility to meet our operating specifications, we and the landlord are making structural changes as part of the uplift of the building. We have the option to expand the facility by an additional 111,000 square feet as well as an option to extend the lease for two additional periods of five years.

ITEM 3. *LEGAL PROCEEDINGS*

We routinely are involved in a number of judicial and administrative proceedings that are incidental to our business. Although adverse decisions (or settlements) may occur in one or more of these cases, it is not possible to estimate the possible loss or losses from each of these cases. The final resolution of these lawsuits, individually or in the aggregate, is not expected to have a material adverse effect on our business, financial position or results of operations. Cases that previously were disclosed may no longer be described because of rulings in the case, settlements, changes in our business or other developments rendering them, in our judgment, no longer material to our business, financial position or results of operations. No material legal proceeding was terminated during the fourth quarter of 2013.

ITEM 4. *MINE SAFETY DISCLOSURES*

Not applicable

PART II

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

Shutterfly's common stock is traded on the NASDAQ Global Select Market under the symbol "SFLY." As of February 10, 2014, there were approximately 85 stockholders of record, excluding stockholders whose shares were held in nominee or street name by brokers. We have never paid cash dividends on our capital stock and we do not anticipate paying any cash dividends in the foreseeable future.

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

Year Ended December 31, 2012	High	Low
First Quarter	$ 33.76	$ 22.70
Second Quarter	$ 31.66	$ 23.75
Third Quarter	$ 34.18	$ 28.68
Fourth Quarter	$ 31.51	$ 25.39

Year Ended December 31, 2013	High	Low
First Quarter	$ 45.09	$ 30.84
Second Quarter	$ 56.11	$ 42.36
Third Quarter	$ 59.83	$ 50.35
Fourth Quarter	$ 57.05	$ 45.12

Issuer Purchases of Equity Securities

On November 1, 2012, we announced a share repurchase program authorized by our Board of Directors and approved by our Audit Committee to repurchase up to $60 million of our common stock. In the quarter ended December 31, 2013, there were no share repurchases under the publicly announced share repurchase program. On February 6, 2014, our Board of Directors approved an increase to this program of up to $100.0 million in addition to amounts repurchased to date, and we expect to utilize the cash under the expanded program through April, 2015.

ITEM 6. ***SELECTED FINANCIAL DATA.***

The consolidated statements of income data for the years ended December 31, 2013, 2012 and 2011 and the consolidated balance sheet data as of December 31, 2013 and 2012 have been derived from our audited consolidated financial statements included elsewhere in this annual report on Form 10-K. The consolidated statements of income data for the years ended December 31, 2010 and 2009 and the consolidated balance sheet data as of December 31, 2011, 2010 and 2009 have been derived from our audited consolidated financial statements not included in this annual report on Form 10-K. The following selected consolidated financial data should be read in conjunction with our "Management's Discussion and Analysis of Financial Condition and Results of Operations" and consolidated financial statements and related notes to those statements included elsewhere in this annual report on Form 10-K.

	Year Ended December 31,				
	2013	2012	2011	2010	2009
	(In thousands, except per share amounts)				
Consolidated Income Statement Data:					
Net revenues	$ 783,642	$ 640,624	$ 473,270	$ 307,707	$ 246,432
Cost of net revenues	369,593	294,857	219,542	134,491	111,648
Gross profit	414,049	345,767	253,728	173,216	134,784
Operating expenses:					
Technology and development	108,995	85,746	65,675	48,393	46,003
Sales and marketing	189,985	148,806	113,952	59,284	44,870
General and administrative	93,011	70,502	58,710	40,764	35,201
Total operating expenses	391,991	305,054	238,337	148,441	126,074
Income from operations	22,058	40,713	15,391	24,775	8,710
Interest expense	(9,446)	(597)	(64)	(42)	(157)
Interest and other income, net	308	42	35	482	814
Income before income taxes	12,920	40,158	15,362	25,215	9,367
Provision for income taxes	(3,635)	(17,160)	(1,314)	(8,088)	(3,514)
Net income	$ 9,285	$ 22,998	$ 14,048	$ 17,127	$ 5,853
Net income per share:					
Basic	$ 0.25	$ 0.64	$ 0.43	$ 0.63	$ 0.23
Diluted	$ 0.24	$ 0.61	$ 0.40	$ 0.59	$ 0.22
Weighted average shares:					
Basic	37,680	35,826	32,788	27,025	25,420
Diluted	39,493	37,432	35,007	29,249	26,810

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

	Year Ended December 31,				
	2013	2012	2011	2010	2009
	(In thousands)				
Cost of net revenues	$ 2,485	$ 1,696	$ 2,138	$ 508	$ 416
Technology and development	9,477	8,635	8,201	3,069	3,340
Sales and marketing	19,774	11,559	11,350	3,923	3,577
General and administration	21,792	15,432	12,181	8,866	6,940
	$ 53,528	$ 37,322	$ 33,870	$ 16,366	$ 14,273

The chart below includes selected data from our balance sheet:

	December 31,				
	2013	2012	2011	2010	2009
			(In thousands)		
Consolidated Balance Sheet Data:					
Cash, cash equivalents, and short term investments	$ 499,084	$ 245,088	$ 179,915	$ 252,244	$ 180,737
Property and equipment, net	155,727	92,667	54,123	39,726	41,845
Working capital	413,338	148,855	130,259	200,282	141,410
Total assets	1,266,142	865,124	709,886	343,830	271,313
Total stockholders' equity	788,095	691,286	608,997	269,607	215,164

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

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report, including the following Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are based upon our current expectations. These forward-looking statements include statements related to our business strategy and plans, expectations regarding the seasonality and growth of our business, the impact on us of general economic conditions, trends in key metrics such as total number of customers and orders and average order value, the decline in average selling prices for prints, our capital expenditures for 2014, the sufficiency of our cash and cash equivalents and cash generated from operations for the next 12 months, our operating expenses remaining a consistent percentage of our net revenues, mergers and acquisitions and the ability to successfully integrate technologies, our new production facilities, as well as other statements regarding our future operations, financial condition and prospects and business strategies. In some cases, you can identify forward-looking statements by terminology such as "project," "believe," "anticipate," "plan," "expect," "estimate," "intend," "continue," "should," "would," "could," "potentially," "will," or "may," or the negative of these terms or other comparable terminology. Forward-looking statements involve risks and uncertainties. Our actual results and the timing of events could differ materially from those anticipated in our forward-looking statements as a result of many factors, including but not limited to, general economic conditions in the United States, consumer sentiment, levels of consumer discretionary spending, the seasonality of our business, whether we are able to expand our customer base and increase our product and service offering, competition in our marketplace and the other risks set forth below under "Risk Factors" in Part I, Item 1A of this report. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. We assume no obligation to update any of the forward-looking statements after the date of this report or to compare these forward-looking statements to actual results.

Overview

We are the leading manufacturer and digital retailer of high-quality personalized products and services offered through a family of lifestyle brands. Our vision is to make the world a better place by helping people share life's joy. Our mission is to build an unrivaled service that enables deeper, more personal relationships between our customers and those who matter most in their lives. Our primary focus is on helping consumers manage their memories through the powerful medium of photography. We provide a full range of personalized photo-based products and services that make it easy, convenient and fun for consumers to upload, edit, enhance, organize, find, share, create, print, and preserve their memories in a creative and thoughtful manner through our seven trusted premium lifestyle brands: Shutterfly, Tiny Prints, Wedding Paper Divas, Treat, ThisLife, MyPublisher and BorrowLenses.

We generate the majority of our revenues by producing and selling professionally-bound photo books, greeting and stationery cards, personalized calendars, other photo-based merchandise and high-quality prints ranging in size from wallet-sized to jumbo-sized 20x30 enlargements. We manufacture most of these items in our Fort Mill, South Carolina, Phoenix, Arizona and Elmsford, New York production facilities. By controlling the production process in our own production facilities, we are able to produce high-quality products, innovate rapidly, maintain a favorable cost structure and ensure timely shipment to customers, even during peak periods of demand. Additionally, we sell a variety of photo-based merchandise that is currently manufactured for us by third parties, such as calendars, mugs, canvas prints, mouse pads, magnets, and puzzles. We generate substantially all of our revenue from sales originating in the United States and our sales cycle has historically been highly seasonal as we generate more than 50% of our total net revenues during our fiscal fourth quarter. Our operations and financial performance depend on general economic conditions in the United States, consumer sentiment and the levels of consumer discretionary spending. We closely monitor these economic measures as their trends are indicators of the health of the overall economy and are some of the key external factors that impact our business.

In 2013, we delivered record financial results for net revenues, which increased 22% to more than $783 million. This increase was driven by a 15% increase in customers, a 14% increase in orders, and a 7% increase in average order value in our consumer category, as well as increased revenues from new and existing customers in our enterprise category. In addition, this growth was also supported by our acquisitions of MyPublisher and BorrowLenses, which expanded our portfolio of premium lifestyle brands to seven, and R&R Images which added additional printing capabilities. We achieved this growth, while simultaneously focusing on long term strategic priorities and investments in consumer facing programs and infrastructure projects that will provide future scale and scope efficiencies. These included the following:

- We launched the beta version of our new, enhanced cloud service, ThisLife, where consumers can gather and organize photos and videos from across devices, cloud services and social networks, and which include easy to use features like facial recognition, duplicate detection, chronological organization, and images search. During 2014, we plan to make continued investments in features and functionality of this service as we exit the beta stage. However, we do not expect to generate a significant amount of revenue from this service in 2014.

- We opened our new Fort Mill, South Carolina production facility, which significantly increased the size of our Southeast manufacturing footprint. During 2013, we entered into leases for new facilities in Shakopee, Minnesota and Tempe, Arizona which are expected to be operational in 2014 and 2015, respectively. Our Shakopee facility will provide us with a production facility in the Midwest, to round out our current West, Northeast, and Southeast capabilities. It will also provide a level of redundancy in our manufacturing network and supply chain. Our Arizona facility will allow us to consolidate all of our locations in the greater Phoenix area, including the recently acquired R&R Images facility, as well as offer flexibility for future expansion.

- During 2013, we decided to move from our current California based co-location facility to a new co-location facility in Las Vegas, Nevada. This move will significantly expand our storage capacity and reduce our power costs. Due to the time duration required for this migration, we expect to incur duplicate co-location facility costs of between $6 million to $8 million during 2014, as both facilities will be operational.

Finally, to provide for strategic flexibility, we increased our cash position and availability to cash, by issuing $300 million aggregate principal amount of 0.25% Senior Convertible notes due 2018 (the "Notes"), and through the sale of warrants (the "Warrants") in a private offering to qualified institutional

buyers in the second quarter of 2013. The conversion prices of the Notes and the strike price of the Warrants were set at a 35% and 75% premium, respectively, of the $47.35 price per share of our common stock at the time of issuance. A portion of the net proceeds from the offering were used to pay the cost of the convertible note hedge transaction entered into as part of the sale of the Notes, and to repurchase $30 million of shares of our common stock. In addition, during the fourth quarter of 2013 we exercised the expansion feature in our credit facility which increased the maximum principal amount that can be borrowed, on a revolving basis, from $125 million to $200 million.

Basis of Presentation

Net Revenues. Our net revenues are comprised of sales generated from Consumer and Enterprise categories.

Consumer. Our Consumer revenues include sales from all of our brands and are derived from the sale of photo-based products, such as photo books, stationery and greeting cards, other photo-based merchandise, photo prints, and the related shipping revenues as well as rental revenue from our BorrowLenses brand. Included in our photo-based merchandise are items such as mugs, iPhone cases, mouse pads, desktop plaques and puzzles. Photo prints consist of wallet, 4x6, 5x7, 8x10, and large format sizes. Revenue from advertising displayed on our websites is also included in Consumer revenues.

Enterprise. Our Enterprise revenues are primarily from variable, four-color direct marketing collateral manufactured and fulfilled for business customers. We continue to focus our efforts in expanding our presence in this market.

Our business is subject to seasonal fluctuations. In particular, we generate a substantial portion of our revenues during the holiday season in the fourth quarter. We also typically experience increases in net revenues during other shopping-related seasonal events, such as Easter, Mother's Day, Father's Day, and Halloween. We generally experience lower net revenues during the first, second and third calendar quarters and have incurred and may continue to incur losses in these quarters. Due to the relatively short lead time required to fulfill product orders, usually one to three business days, order backlog is not material to our business.

To further understand net revenue trends in our Consumer category, we monitor several key metrics including, total customers, total number of orders, and average order value.

Total Customers. We closely monitor total customers as a key indicator of demand. Total customers represents the number of transacting customers in a given period. We seek to expand our customer base by empowering our existing customers with sharing and collaboration services, and by conducting integrated marketing and advertising programs. We also acquire new customers through customer list acquisitions. Total customers have increased on an annual basis for each year since inception and we expect this trend to continue.

Total Number of Orders. We closely monitor total number of orders as a leading indicator of net revenue trends. We recognize net revenues associated with an order when the products have been shipped and all other revenue recognition criteria have been met. Orders are typically processed and shipped in approximately three business days after a customer places an order. Total number of orders has increased on an annual basis for each year since 2000, and we anticipate this trend to continue in the future.

Average Order Value. Average order value is Consumer net revenues for a given period divided by the total number of customer orders recorded during that same period. Average order value is impacted by product sales mix and pricing and promotional strategies, including our promotions and competitor promotional activity. As a result, we expect that our average order values may fluctuate on an annual basis.

We believe the analysis of these metrics and others described below under "Non-GAAP Financial Measures" provides us with important information on our overall net revenue trends and operating results. Fluctuations in these metrics are not unusual and no single factor is determinative of our net revenues and operating results.

Cost of Net Revenues. Cost of net revenues consists primarily of direct materials (the majority of which consists of paper, ink, and photo book covers), payroll and related expenses for direct labor, shipping charges, packaging supplies, distribution and fulfillment activities, rent for production facilities, depreciation of the facilities where we are the deemed owner (for accounting purposes only) of the building, depreciation of production equipment, and third-party costs for photo-based merchandise. Cost of net revenues also includes payroll and related expenses for personnel engaged in customer service, any third-party software or patents licensed, as well as the amortization of acquired developed technology, capitalized website and software development costs, and patent royalties. Cost of net revenues also includes certain costs associated with facility closures and restructuring.

Operating Expenses. Operating expenses consist of technology and development, sales and marketing, and general and administrative expenses. We anticipate that each of the following categories of operating expenses will increase in absolute dollar amounts, but remain relatively consistent as a percentage of net revenues.

Technology and development expense consists primarily of personnel and related costs for employees and contractors engaged in the development and ongoing maintenance of our websites, infrastructure and software. These expenses include depreciation of the computer and network hardware used to run our websites and store the customer data, including storage for our new ThisLife brand service, as well as amortization of purchased software. Technology and development expense also includes co-location, power and bandwidth costs.

Sales and marketing expense consists of costs incurred for marketing programs, and personnel and related expenses for our customer acquisition, product marketing, business development, and public relations activities. Our marketing efforts consist of various online and offline media programs, such as e-mail and direct mail promotions, the purchase of keyword search terms and various strategic alliances. We depend on these efforts to attract customers to our service.

General and administrative expense includes general corporate costs, including rent for our corporate offices, insurance, depreciation on information technology equipment, and legal and accounting fees. Transaction costs are also included in general and administrative expense. In addition, general and administrative expense includes personnel expenses of employees involved in executive, finance, accounting, human resources, information technology and legal roles. Third-party payment processor and credit card fees are also included in general and administrative expense and have historically fluctuated based on revenues during the period. All of the payments we have received from our intellectual property license agreements have been included as an offset to general and administrative expense.

Interest Expense. Interest expense consists of interest on our convertible senior notes arising from amortization of debt discount, amortization of debt issuance costs, and our 0.25% coupon payment; costs

associated with our five-year syndicated credit facility that became effective in November 2011, as amended in May and December 2013; and costs associated with our capital leases and build-to-suit lease financing obligations.

Interest and Other Income, Net. Interest and other income, net primarily consists of the interest earned on our cash and investment accounts.

Income Taxes. We account for income taxes under the liability method. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities. We are subject to taxation in the United States and Israel.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation of our financial condition or results of operations will be affected.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application, while in other cases, management's judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions. We believe that the accounting policies discussed below are the most critical to understanding our historical and future performance, as these policies relate to the more significant areas involving management's judgments and estimates.

Revenue Recognition. We recognize revenue from Consumer and Enterprise product sales, net of applicable sales tax, upon shipment of fulfilled orders, when persuasive evidence of an arrangement exists, the selling price is fixed or determinable and collection of resulting receivables is reasonably assured. Customers place Consumer product orders through our websites and pay primarily using credit cards. Enterprise customers are invoiced upon fulfillment. Shipping charged to customers is recognized as revenue at the time of shipment.

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

For gift card sales and flash deal promotions through group buying websites, we recognize revenue on a gross basis, as we are the primary obligor, when redeemed items are shipped. Revenues from sales of prepaid orders on our websites are deferred until shipment of fulfilled orders or until the prepaid period expires. Our share of revenue generated from our print to retail relationships, is recognized when orders are picked up by our customers at the respective retailer.

We provide our customers with a 100% satisfaction guarantee whereby products can be returned within a 30-day period for a reprint or refund. We maintain an allowance for estimated future returns

based on historical data. The provision for estimated returns is included in accrued expenses. During the year ended December 31, 2013, returns totaled approximately 1% of net revenues and have been within management's expectations.

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

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

Inventories. Our inventories consist primarily of paper, photo book covers and packaging supplies and are stated at the lower of cost on a first-in, first-out basis or net realizable value. The value of inventories is reduced by an estimate for excess and obsolete inventories. The estimate for excess and obsolete inventories is based upon management's review of utilization of inventories in light of projected sales, current market conditions and market trends.

Fair Value. We record our financial assets and liabilities at fair value. The accounting standard for fair value provides a framework for measuring fair value, clarifies the definition of fair value and expands disclosures regarding fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The accounting standard establishes a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Goodwill and Intangible Assets. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Intangible assets resulting from the acquisition of entities accounted for using the purchase method of accounting are estimated by management based on the fair value of assets received. Intangible assets are amortized on a straight-line basis over the estimated useful lives which range from one to sixteen years, and the amortization is allocated between cost of net revenues and operating expenses. Goodwill and intangible assets with indefinite lives are not subject to amortization, but are tested for impairment on an annual basis during our fourth quarter or whenever events or changes in circumstances indicate the carrying amount of these assets may not be recoverable.

Software and Website Development Costs. We capitalize costs associated with website development and software developed or obtained for internal use. Accordingly, payroll and payroll-related costs and stock-based compensation incurred in the development phase are capitalized and amortized over the product's estimated useful life, which is generally three years. Costs associated with minor enhancements and maintenance for our website are expensed as incurred.

Income Taxes. We use the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized by applying the statutory tax rates in effect in the years in which the differences between the financial reporting and tax filing bases of existing assets and liabilities are expected to reverse. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance against our deferred tax assets. In 2013, our valuation allowance against certain California deferred tax assets increased to $2.9 million from $2.2 million in 2012. We believe that all other net deferred tax assets shown on our balance sheet are more likely than not to be realized in the future and no additional valuation allowance is necessary. In the event that actual results differ from those estimates or we adjust those estimates in future periods, we may need to adjust the valuation allowance, which will impact deferred tax assets and the results of operations in the period the change is made.

We report a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. We are required to make subjective assumptions and judgments regarding our income tax exposures. Interpretations and guidance surrounding income tax laws and regulations change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of income.

Our policy is to recognize interest and/or penalties related to all tax positions in income tax expense. To the extent that accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision in the period that such determination is made.

Stock-Based Compensation Expense. We measure our stock based awards at fair value and recognize compensation expense for all share-based payment awards made to our employees and directors, including employee stock options and restricted stock awards.

We estimate the fair value of stock options granted using the Black-Scholes valuation model. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of our common stock price using historical and implied volatility and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in our consolidated statements of income.

The cost of restricted stock awards and performance based restricted stock awards is determined using the fair value of our common stock on the date of grant. Compensation expense is recognized for restricted stock awards on a straight-line basis over the vesting period. Compensation expense associated with performance based restricted stock awards is recognized on an accelerated attribution model, and ultimately based on whether or not satisfaction of the performance criteria is probable. If in the future, situations indicate that the performance criteria are not probable, then no further compensation cost will be recorded, and any previous costs will be reversed.

Results of Operations

The following table presents the components of our income statement as a percentage of net revenues:

	Year Ended December 31,		
	2013	2012	2011
Net revenues	100%	100%	100%
Cost of net revenues	47	46	46
Gross profit	53	54	54
Operating expenses:			
Technology and development	14	13	14
Sales and marketing	24	23	24
General and administrative	12	11	13
Total operating expenses	50	47	51
Income from operations	3	7	3
Interest expense	(1)	—	—
Interest and other income, net	—	—	—
Income before income taxes	2	7	3
Provision for income taxes	(1)	(3)	—
Net income	1%	4%	3%

Comparison of the Years Ended December 31, 2013 and 2012

	Year Ended December 31,			
	2013	2012	$ Change	% Change
	(in thousands, except AOV amounts)			
Net revenues				
Consumer	$ 745,969	$ 613,445	$ 132,524	22%
Enterprise	37,673	27,179	10,494	39%
Total net revenues	783,642	640,624	143,018	22%
Cost of net revenues	369,593	294,857	74,736	25%
Gross profit	$ 414,049	$ 345,767	$ 68,282	20%
Percentage of net revenues	*53%*	*54%*	—	—
Key Metrics				
Customers	8,094	7,062	1,032	15%
Orders	18,561	16,322	2,239	14%
Average order value	$ 40.19	$ 37.58	$ 2.61	7%

Net revenues increased $143.0 million, or 22%, in 2013 compared to 2012. Revenue growth was attributable to increases in both revenue categories. Consumer net revenues increased $132.5 million, or 22%, in 2013 compared to 2012, and represented 95% of total net revenues in 2013 compared to 96% in 2012. The increase in Consumer net revenues is primarily the result of increased sales of greeting and stationery cards, photo books, including net revenues from the recently acquired MyPublisher brand, and other photo-based merchandise. The increase is also reflected in the increases in all of our key metrics in 2013, as compared to 2012, as noted above. Partially offsetting this increase were larger than expected refunds during the fourth quarter of 2013 due to production issues at our Tiny Prints brand, as well as the impact of losing an important sales partner in the fourth quarter, primarily for our Tiny Prints brand.

Enterprise revenues increased $10.5 million, or 39%, in 2013 compared to 2012, and represented 5% of total net revenues in 2013 compared to 4% in 2012. The increase is a combination of new Enterprise customers as well as increased sales to existing customers.

Cost of net revenues increased $74.7 million, or 25%, in 2013 compared to 2012. As a percentage of net revenues, cost of net revenues increased to 47% in 2013 compared to 46% in 2012, with gross margin decreasing to 53% in 2013 from 54% in 2012. Overall, the increase in cost of net revenues was primarily the result of the increased volume of shipped products as well as increased depreciation from our expanded and recently acquired manufacturing facilities and equipment, and increased amortization expense associated with purchase accounting and capitalized software and website development costs.

	Year Ended December 31,			
	2013	2012	$ Change	% Change
	(in thousands)			
Technology and development	$ 108,995	$ 85,746	$ 23,249	27%
Percentage of net revenues	*14%*	*13%*	—	—
Sales and marketing	$ 189,985	$ 148,806	$ 41,179	28%
Percentage of net revenues	*24%*	*23%*	—	—
General and administrative	$ 93,011	$ 70,502	$ 22,509	32%
Percentage of net revenues	*12%*	*11%*	—	—

Our technology and development expense increased $23.2 million, or 27%, in 2013, compared to 2012. As a percentage of net revenues, technology and development expense increased to 14% in 2013 from 13% in 2012. The increase in technology and development expense was primarily due to an increase of $14.4 million in personnel and related costs, reflecting additional hires during 2013. There was also an increase of $6.0 million in depreciation and amortization expense, an increase of $2.6 million in professional fees, an increase of $1.6 million in stock-based compensation, and an increase of $1.0 million in facility costs primarily from co-location services. These factors were partially offset by an increase of $3.0 million in software and website development costs capitalized in the current period compared to the same period in the prior year.

During 2013, headcount in technology and development increased by 31% compared to 2012, reflecting our strategic focus to increase the rate of innovation in our product and services offerings, to generate greater differentiation from our competitors, and improve our long-term operating efficiency. In 2013, we capitalized $15.3 million in eligible salary and consultant costs, including $1.7 million of stock-based compensation, associated with software developed or obtained for internal use, compared to $12.4 million, which included $0.9 million of stock-based compensation capitalized in 2012.

Our sales and marketing expense increased $41.2 million, or 28%, in 2013 compared to 2012. As a percentage of net revenues, total sales and marketing expense increased to 24% in 2013 from 23% in 2012. The increase in sales and marketing expense was primarily due to an increase of $20.2 million related to direct response, expanded online and performance marketing campaigns, and brand advertising, including TV, radio, and out-of-home. The increase is also attributable to an increase of $8.2 million in stock-based compensation, an increase of $7.6 million in personnel and related costs associated with the expansion of our internal marketing team, an increase of $3.6 million in intangible asset amortization primarily from the Kodak Gallery customer list and intangibles acquired in the MyPublisher and BorrowLenses acquisitions, and an increase of $1.4 million in professional fees.

Our general and administrative expense increased $22.5 million, or 32%, in 2013 compared to 2012. As a percentage of net revenues, general and administrative expense increased to 12% in 2013 from 11% in

2012. The increase in general and administrative expense is primarily due to an increase in stock-based compensation of $6.4 million as a result of increased headcount and an increase in depreciation and amortization of $4.5 million. There was also an increase in personnel related costs of $3.9 million, an increase in credit card fees of $3.3 million which was driven by the increase in Consumer net revenues as compared to the prior year, an increase in facility costs of $1.5 million, and an increase in professional fees of $1.5 million, offset by a reduction in the gains on disposition of assets of $0.9 million in 2013.

	Year Ended December 31,		
	2013	2012	Change
	(in thousands)		
Interest expense	$ (9,446)	$ (597)	$ (8,849)
Interest and other income, net	308	42	266

Interest expense consists of interest on our convertible senior notes arising from amortization of debt discount, amortization of debt issuance costs, and our 0.25% coupon, issuance costs associated with our credit facility; capital leases and our financing obligation associated with our Fort Mill, South Carolina production facility. Interest expense was $9.4 million for the year ended December 31, 2013 compared to $0.6 million during 2012. The increase is primarily due to $8.2 million of interest expense associated with our May 2013 issuance of $300.0 million of 0.25% convertible senior notes.

	Year Ended December 31,	
	2013	2012
	(in thousands)	
Income tax provision	$ (3,635)	$ (17,160)
Effective tax rate	28%	43%

The provision for income taxes was $3.6 million for 2013, compared to a provision of $17.2 million for 2012. Our effective tax rate was 28% in 2013 and 43% in 2012. The decrease in our effective tax rate was primarily the result of higher disqualifying dispositions of incentive stock option awards and the enactment during 2013 of the federal research credit for fiscal 2013 and 2012, offset by non-deductible executive compensation.

	Year Ended December 31,			
	2013	2012	$ Change	% Change
	(in thousands)			
Income before income taxes	$ 12,920	$ 40,158	$ (27,238)	(68)%
Net income	9,285	22,998	(13,713)	(60)%
Percentage of net revenues	*1%*	*4%*	—	—

Net income decreased by $13.7 million for 2013 compared to 2012. As a percentage of net revenues, net income decreased to 1% in 2013 from 4% in 2012.

Comparison of the Years Ended December 31, 2012 and 2011

	Year Ended December 31,			
	2012	2011	$ Change	% Change
	(in thousands)			
Net revenues				
Consumer	$ 613,445	$ 459,725	$ 153,720	33%
Enterprise	27,179	13,545	13,634	101%
Total net revenues	640,624	473,270	167,354	35%
Cost of net revenues	294,857	219,542	75,315	34%
Gross profit	$ 345,767	$ 253,728	92,039	36%
Percentage of net revenues	*54%*	*54%*	—	—

Net revenues increased $167.4 million, or 35%, in 2012 compared to 2011. Revenue growth was attributable to increases in both revenue categories and driven by strong customer acquisition and an increased number of transacting customers and orders. Consumer net revenues increased $153.7 million, or 33%, in 2012 compared to 2011, and represented 96% of total net revenues in 2012 compared to 97% in 2011. The increase in Consumer net revenues is primarily a result of increased sales of greeting and stationery cards and photo books with a smaller contribution from increased sales of other photo-based merchandise. Enterprise revenues increased $13.6 million, or 101%, in 2012 compared to 2011, and represented 4% of total net revenues in 2012 compared to 3% in 2011. The increase is a combination of new Enterprise customers as well as increased sales to existing customers.

Consumer net revenue increases were also the result of year-over-year increases in total transacting customers and orders as outlined below. Average order value was flat year-over-year.

	Year Ended December 31,			
Shutterfly	2012	2011	Change	% Change
	(In thousands, except AOV amounts)			
Customers	7,062	5,388	1,674	31%
Orders	16,322	12,340	3,982	32%
Average order value	$ 37.58	$ 37.25	$ 0.33	1%

On a pro forma basis, including the orders and revenue of Tiny Prints for the period prior to the acquisition date, total orders for the year ended December 31, 2011 was 12,676,000 resulting in an average order value of $38.30, a decrease of 2%.

Cost of net revenues increased $75.3 million, or 34%, in 2012 compared to 2011, however, it remained flat as a percentage of net revenues at 46%, with gross margin remaining flat at 54%. Overall, the increase in cost of net revenues was primarily the result of the increased volume of shipped products, increased headcount and greater third-party fulfillment costs associated with Tiny Prints products. Gross margin

percentage was benefited by scale efficiencies, but offset by increased volumes of lower margin Enterprise sales.

	Year Ended December 31,			
	2012	2011	$ Change	% Change
	(in thousands)			
Technology and development	$ 85,746	$ 65,675	$ 20,071	31%
Percentage of net revenues	*13%*	*14%*	—	—
Sales and marketing	$ 148,806	$ 113,952	$ 34,854	31%
Percentage of net revenues	*23%*	*24%*	—	—
General and administrative	$ 70,502	$ 58,710	$ 11,792	20%
Percentage of net revenues	*11%*	*13%*	—	—

Our technology and development expense increased $20.1 million, or 31%, in 2012, compared to 2011. As a percentage of net revenues, technology and development expense decreased to 13% in 2012 from 14% in 2011. The increase in technology and development expense was primarily due to an increase of $10.9 million related to personnel and related costs, reflecting additional hires during 2012, as well as the inclusion of the Tiny Prints development team for the entire year 2012. There was also an increase of $5.6 million related to incremental costs associated with our acquisition of Photoccino and Kodak Gallery's accounts. The overall increase was also due to an increase of $3.5 million in depreciation expense, an increase of $2.2 million in professional fees, and an increase of $0.8 million in stock based compensation. These factors were partially offset by an increase of $3.1 million in website development costs capitalized in the current period compared to the same period in the prior year.

During 2012, headcount in technology and development increased by 24% compared to 2011, reflecting our strategic focus to increase the rate of innovation in our product and services offerings, to generate greater differentiation from our competitors, and improve our long-term operating efficiency. In 2012, we capitalized $12.4 million in eligible salary and consultant costs, including $0.9 million of stock-based compensation, associated with software developed or obtained for internal use, compared to $9.2 million, which included $0.5 million of stock-based compensation capitalized in 2011.

Our sales and marketing expense increased $34.9 million, or 31%, in 2012 compared to 2011. As a percentage of net revenues, total sales and marketing expense decreased to 23% in 2012 from 24% in 2011. The increase in sales and marketing expense was primarily due to an increase of $18.1 million related to direct response, expanded online and performance marketing campaigns, and TV advertising, such as our first national cable TV campaign. The increase is also attributable to an increase of $9.2 million in personnel and related costs associated with the expansion of our internal marketing team and an increase of $7.0 million in intangible asset amortization primarily from the Kodak Gallery customer list and a full year of intangible asset amortization from the Tiny Prints acquisition.

Our general and administrative expense increased $11.8 million, or 20%, in 2012 compared to 2011. As a percentage of net revenues, general and administrative expense decreased to 11% in 2012 from 13% for 2011. The increase in general and administrative expense is primarily due to an increase in personnel related costs of $4.5 million and an increase in stock-based compensation of $3.3 million as a result of increased headcount. There was also an increase in credit card fees of $3.2 million which was driven by the increase in Consumer net revenues as compared to the prior year, an increase in depreciation of $0.8 million, and an increase in facilities of $0.8 million. The increases were partially offset by a decrease in

professional fees of $0.7 million which are largely due to transaction costs related to our acquisition of Tiny Prints incurred in 2011, and gains on disposition of assets of $0.6 million in 2012.

	Year Ended December 31,		
	2012	2011	Change
		(in thousands)	
Interest expense	$ (597)	$ (64)	$ (533)
Interest and other income, net	42	35	7

Interest expense increased in 2012 compared to 2011 primarily due to origination and ongoing commitment fees from our five-year syndicated credit facility that became effective in November 2011.

	Year Ended December 31,	
	2012	2011
	(in thousands)	
Income tax provision	$ (17,160)	$ (1,314)
Effective tax rate	43%	9%

The provision for income taxes was $17.2 million for 2012, compared to a provision of $1.3 million for 2011. Our effective tax rate was 43% in 2012 and 9% in 2011. This increase in our effective tax rate was primarily the result of fewer disqualifying dispositions of incentive stock option awards in the current year, a delay in the extension of the federal research credit, and a valuation allowance on certain California deferred tax assets.

	Year Ended December 31,			
	2012	2011	$ Change	% Change
		(in thousands)		
Income before income taxes	$ 40,158	$ 15,362	$ 24,796	161%
Net income	22,998	14,048	8,950	64%
Percentage of net revenues	*4%*	*3%*	—	—

Net income increased by $9.0 million for 2012 compared to 2011. As a percentage of net revenues, net income increased to 4% in 2012 from 3% in 2011.

Liquidity and Capital Resources

At December 31, 2013, we had $499.1 million of cash. To supplement our overall liquidity position, during the year ended December 31, 2013 we issued $300.0 million of 0.25% convertible senior notes due May 15, 2018. Further, since November 2011, we have had access to a five-year senior secured syndicated credit facility to provide up to $125.0 million in additional capital resources. In December 2013, we exercised the expansion feature in this facility which increased the maximum principal amount that can be borrowed, on a revolving basis, to $200.0 million. As of December 31, 2013, no amounts have been drawn against this facility.

Below is our cash flow activity for the years ended December 31, 2013, 2012 and 2011:

	Year Ended December 31,		
	2013	2012	2011
		(in thousands)	
Consolidated Statements of Cash Flows Data:			
Purchases of property and equipment	$ 62,582	$ 40,535	$ 23,149
Capitalization of software and website development costs	15,760	12,528	10,050
Depreciation and amortization	74,856	50,109	34,452
Acquisition of business and intangible assets, net of cash acquired	76,893	57,212	133,705
Cash flows provided by operating activities	147,268	151,381	63,248
Cash flows used in investing activities	(154,847)	(109,289)	(166,228)
Cash flows provided by financing activities	261,575	23,081	30,651

We anticipate that our current cash balances and cash generated from operations will be sufficient to meet our strategic and working capital requirements, lease obligations, technology development projects, coupon payments for our 0.25% convertible senior notes, and to fund any repurchases of shares of our common stock under our Share Repurchase Program announced in November 2012, and revised and expanded in February 2014, for at least the next twelve months. Whether these resources are adequate to meet our liquidity needs beyond that period will depend on our growth, operating results and the capital expenditures required to meet possible increased demand for our products. If we require additional capital resources to grow our business internally or to acquire complementary technologies and businesses at any time in the future, we may seek to sell additional debt or additional equity. The sale of additional equity or convertible debt could result in significant dilution to our stockholders. Financing arrangements may not be available to us, or may not be in amounts or on terms acceptable to us.

We anticipate that total 2014 capital expenditures will range from 9.5% to 10.5% of our expected net revenues in 2014, which includes additional investments related to our Shakopee, Minnesota and Tempe, Arizona production facilities which we expect will be operational in 2014 and 2015, respectively, and related to the move and expansion of our co-location facility from California to Nevada. During 2014, we expect to incur between $6.0 million and $8.0 million in additional, duplicate data center co-location operating costs as we migrate from our existing co-location facility to this new facility in Las Vegas, Nevada. These expenditures will be used to purchase technology and equipment to support the growth in our business and to increase our production capacity, and help enable us to respond more quickly and efficiently to customer demand. A smaller but significant component of these expenditures includes costs associated with capitalized software and website development, as we continue to support our innovative engineering and product development strategies. This range of capital expenditures is not outside the ordinary course of our business or materially different from how we have expanded our business in the past.

The following table shows total capital expenditures including amounts accrued but not yet paid by category for the years ended December 31, 2013, 2012 and 2011:

	Year Ended December 31,		
	2013	2012	2011
		(in thousands)	
Technology equipment and software	$ 32,330	$ 28,386	$ 13,956
Percentage of total capital expenditures	*43%*	*47%*	*42%*
Manufacturing equipment, rental equipment, and building improvements	26,880	19,843	9,605
Percentage of total capital expenditures	*36%*	*33%*	*29%*
Capitalized technology and development costs	15,760	12,528	10,050
Percentage of total capital expenditures	*21%*	*21%*	*30%*
Total Capital Expenditures	**$ 74,970**	**$ 60,757**	**$ 33,611**
Percentage of net revenues	*10%*	*9%*	*7%*

Operating Activities. For 2013, net cash provided by operating activities was $147.3 million, primarily due to our net income of $9.3 million and adjustments for non-cash items including $53.5 million of stock-based compensation, $43.9 million of depreciation and amortization, and $31.0 million of amortization of intangible assets. Net cash provided by operating activities was also adjusted for amortization of debt discount and transaction costs of $7.7 million and the net change in operating assets and liabilities of $2.2 million.

For 2012, net cash provided by operating activities was $151.4 million, primarily due to our net income of $23.0 million and the net change in operating assets and liabilities of $43.8 million. Net cash provided by operating activities was adjusted for non-cash items including $50.1 million of depreciation and amortization expense and $37.3 million of stock-based compensation.

For 2011, net cash provided by operating activities was $63.2 million, primarily due to our net income of $14.0 million and the net change in operating assets and liabilities of $13.1 million, adjusted for non-cash items including $34.5 million of depreciation and amortization expense, $33.9 million of stock-based compensation, and $5.8 million provision from deferred income taxes.

Investing Activities. For 2013, net cash used in investing activities was $154.8 million. We used $76.9 million to acquire MyPublisher, R&R Images, and BorrowLenses, net of cash acquired, and to settle other acquisition related liabilities. We used $62.6 million for capital expenditures for computer and network hardware and production equipment for our manufacturing operations, and $15.8 million of capitalized software and website development. Additionally, we received proceeds of $0.4 million from the sale of equipment.

For 2012, net cash used in investing activities was $109.3 million. We used $24.4 million in the acquisition of Kodak Gallery's customer accounts and images and $32.8 million in the acquisitions of Photoccino Ltd, Penguin Digital, Inc., and ThisLife, Inc., net of cash acquired. We used $40.5 million for capital expenditures for computer and network hardware and production equipment for our manufacturing operations, and $12.5 million of capitalized software and website development. Additionally, we received proceeds of $1.0 million from the sale of equipment.

For 2011, net cash used in investing activities was $166.2 million. We used $133.1 million in the acquisition of Tiny Prints net of cash acquired, $23.1 million for capital expenditures for computer and

network hardware and production equipment for our manufacturing operations and $10.1 million of capitalized software and website development.

Financing Activities. For 2013, net cash provided by financing activities was $261.6 million, primarily from the $291.9 million in proceeds from the issuance of our 0.25% convertible senior notes in May 2013, $43.6 million in proceeds from the issuance of warrants, offset by $63.5 million from the purchase of a convertible note hedge and repurchases of common stock of $32.2 million. We also received $19.1 million of proceeds from issuance of common stock from the exercise of options and recorded $3.6 million from excess tax benefit from stock-based compensation.

For 2012, net cash provided by financing activities was $23.1 million, primarily from $16.6 million from excess tax benefits from stock-based compensation and $10.2 million of proceeds from issuance of common stock from the exercise of options. This was partially offset by repurchases of common stock of $3.8 million.

For 2011, net cash provided by financing activities was $30.7 million, primarily from $22.3 million of proceeds from issuance of common stock upon exercise of stock options and $8.4 million excess tax benefit from stock-options.

Non-GAAP Financial Measures

Regulation G, conditions for use of Non-Generally Accepted Accounting Principles (“Non-GAAP”) financial measures, and other SEC regulations define and prescribe the conditions for use of certain Non-GAAP financial information. We closely monitor three financial measures, adjusted EBITDA, free cash flow, and Non-GAAP earnings per share which meet the definition of Non-GAAP financial measures. We define adjusted EBITDA as earnings before interest, taxes, depreciation, amortization, and stock-based compensation. Free cash flow is defined as adjusted EBITDA less purchases of property and equipment and capitalization of software and website development costs. Free cash flow has limitations due to the fact that it does not represent the residual cash flow for discretionary expenditures. For example, free cash flow does not incorporate payments made on capital lease obligations or cash requirements to comply with debt covenants. Non-GAAP earnings per share is defined as Non-GAAP net income (loss), which excludes interest expense related to the issuance of our 0.25% convertible senior notes in May 2013, divided by diluted non-GAAP shares outstanding, which is GAAP weighted average shares outstanding less any shares issuable under our convertible senior notes. Management believes these Non-GAAP financial measures reflect an additional way of viewing our profitability and liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our earnings and cash flows. Refer below for a reconciliation of adjusted EBITDA, free cash flow, and Non-GAAP earnings per share to the most comparable GAAP measure.

To supplement our consolidated financial statements presented on a GAAP basis, we believe that these Non-GAAP measures provide useful information about our core operating results and thus are appropriate to enhance the overall understanding of our past financial performance and our prospects for the future. These adjustments to our GAAP results are made with the intent of providing both management and investors a more complete understanding of our underlying operational results and trends and performance. Management uses these Non-GAAP measures to evaluate our financial results, develop budgets, manage expenditures, and determine employee compensation. The presentation of additional information is not meant to be considered in isolation or as a substitute for or superior to net income (loss) or net income (loss) per share determined in accordance with GAAP. We believe that it is important to view free cash flow as a complement to our reported consolidated financial statements.

Management strongly encourages shareholders to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

The table below shows the trend of adjusted EBITDA and free cash flow as a percentage of net revenues and Non-GAAP net income per share for the years ended December 31, 2013, 2012, and 2011 (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Net revenues	$ 783,642	$ 640,624	$ 473,270
Non-GAAP adjusted EBITDA	$ 150,442	$ 128,144	$ 83,713
Percentage of net revenues	*19%*	*20%*	*18%*
Free cash flow	$ 75,472	$ 67,387	$ 50,102
Percentage of net revenues	*10%*	*11%*	*11%*
Non-GAAP net income per share	$ 0.38	$ 0.61	$ 0.40

We carefully manage our operating costs and capital expenditures, in order to make the strategic investments necessary to grow and strengthen our business, while at the same time increasing our adjusted EBITDA profitability and improving our free cash flows. Over the last three years, our full year adjusted EBITDA profitability has improved to $150.4 million in 2013 from $83.7 million in 2011. This continued growth in adjusted EBITDA profitability resulted from increased demand for our products and services, scale efficiencies, and improvements from product mix. The increase in adjusted EBITDA is also driven by higher net revenues in 2013 as compared to prior years. We also increased our free cash flow to $75.5 million in 2013 from $50.1 million in 2011.

The following is a reconciliation of adjusted EBITDA, free cash flow, and Non-GAAP income per share to the most comparable GAAP measure, for the years ended December 31, 2013, 2012, and 2011 (in thousands):

Reconciliation of Net Income to Non-GAAP Adjusted EBITDA	Year Ended December 31,		
	2013	2012	2011
Net income	$ 9,285	$ 22,998	$ 14,048
Add back:			
Interest expense	9,446	597	64
Interest and other income, net	(308)	(42)	(35)
Tax provision	3,635	17,160	1,314
Depreciation and amortization	74,856	50,109	34,452
Stock-based compensation expense	53,528	37,322	33,870
Non-GAAP Adjusted EBITDA	$ 150,442	$ 128,144	$ 83,713

Reconciliation of Cash Flow from Operating Activities to Non-GAAP Adjusted EBITDA and Free Cash Flow

	Year Ended December 31,		
	2013	2012	2011
Net cash provided by operating activities	$ 147,268	$ 151,381	$ 63,248
Add back:			
Interest expense	9,446	597	64
Interest and other income, net	(308)	(42)	(35)
Tax provision	3,635	17,160	1,314
Changes in operating assets and liabilities	(2,226)	(43,762)	13,066
Other adjustments	(7,373)	2,810	6,056
Non-GAAP Adjusted EBITDA	150,442	128,144	83,713
Less:			
Purchases of property and equipment, including accrued amounts	(59,210)	(48,229)	(23,561)
Capitalized technology & development costs	(15,760)	(12,528)	(10,050)
Free cash flow	$ 75,472	$ 67,387	$ 50,102

Reconciliation of Net Income per Share to Non-GAAP Net Income per Share

	Year Ended December 31,		
	2013	2012	2011
GAAP Net income	$ 9,285	$ 22,998	$ 14,048
Add back interest expense related to:			
Amortization of debt discount	7,002	—	—
Amortization of debt issuance costs	705	—	—
0.25% coupon	469	—	—
Tax effect	(2,300)	—	—
Non-GAAP net income	$ 15,161	$ 22,998	$ 14,048
GAAP diluted shares outstanding	39,493	37,432	35,007
Add back:			
Dilutive effect of convertible notes	—	—	—
Non-GAAP shares outstanding	39,493	37,432	35,007
GAAP net income per share	$ 0.24	$ 0.61	$ 0.40
Non-GAAP net income per share	$ 0.38	$ 0.61	$ 0.40

Contractual Obligations

The following are contractual obligations at December 31, 2013, associated with lease obligations and other arrangements:

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
			(in thousands)		
Contractual Obligations					
Convertible Senior Notes, including interest	$ 303,375	$ 750	$ 1,500	$ 301,125	$ —
Capital lease obligations	6,554	1,731	2,994	1,829	—
Operating lease obligations(1)	62,859	17,863	29,950	11,571	3,475
Build-to-suit lease obligations(2)	62,484	2,066	10,502	12,083	37,833
Purchase obligations(3)	100,587	16,325	26,207	31,609	26,446
Total contractual obligations	$ 535,859	$ 38,735	$ 71,153	$ 358,217	$ 67,754

(1) Includes office space in Redwood City and Santa Clara, California, and Tempe, Arizona and certain production facilities under non-cancelable operating leases. We also have various non-cancelable operating leases for certain production equipment. Specifically, in 2013, 2012, and 2011, we entered into multiple non-cancelable operating leases for new digital presses and finishing equipment with terms that expire in up to five years.

(2) Includes the estimated timing and amount of payments for rent for our newly leased production facility spaces in Fort Mill, South Carolina, Shakopee, Minnesota and Tempe, Arizona. See *"Notes to Consolidated Financial Statements — Note 5 — Commitments and Contingencies"* for further discussion.

(3) Includes co-location agreements with third-party hosting facilities that expire in 2020 as well as minimums under marketing agreements.

Other than the obligations, liabilities and commitments described above, we have no significant unconditional purchase obligations or similar instruments. We are not a guarantor of any other entities' debt or other financial obligations.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not have any undisclosed borrowings or debt and we have not entered into any synthetic leases. We are, therefore, not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

In 2013, the FASB issued a new accounting standard that will require the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the Consolidated Balance Sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new standard requires adoption on a prospective basis in the first quarter of 2015; however,

early adoption is permitted. We do not anticipate that this adoption will have a significant impact on our financial position, results of operations, or cash flows.

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Interest Rate and Credit Risk. We have exposure to interest rate risk that relates primarily to our investment portfolio and our syndicated credit facility. All of our cash equivalents are carried at market value. We may draw funds from our syndicated credit facility under interest rates based on either the Federal Funds Rate or the Adjusted London Interbank Offered Rate ("LIBO rate"). If these rates increase significantly, our costs to borrow these funds will also increase. To date, we have not borrowed any funds under our syndicated credit facility. We do not believe that a 10% change in interest rates would have a significant impact on our interest income and expense, operating results, or liquidity.

Market Risk and Market Interest Risk. In May 2013, we issued $300.0 million of 0.25% convertible senior notes due May 15, 2018. We carry this instrument at face value less unamortized discount on our balance sheet. Since this instrument bears interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of these instruments fluctuates when interest rates change, and in the case of convertible notes, when the market price of our stock fluctuates.

Inflation. We do not believe that inflation has had a material effect on our current business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, for example, if the cost of our materials or the cost of shipping our products to customers were to incur substantial increases as a result of the rapid rise in the cost of oil, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

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

SHUTTERFLY, INC.
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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Shutterfly, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, stockholders equity, and cash flows present fairly, in all material respects, the financial position of Shutterfly, Inc., and its subsidiaries at December 31, 2013 and December 31, 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control – Integrated Framework (1992),* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

San Jose, California
February 13, 2014

SHUTTERFLY, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except par value amounts)

	December 31,	
	2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 499,084	$ 245,088
Accounts receivable, net	21,641	13,574
Inventories	9,629	5,032
Deferred tax asset, current portion	26,942	7,713
Prepaid expenses and other current assets	21,260	15,268
Total current assets	578,556	286,675
Property and equipment, net	155,727	92,667
Intangible assets, net	118,621	122,269
Goodwill	397,306	358,349
Deferred tax asset, net of current portion	520	854
Other assets	15,412	4,310
Total assets	$ 1,266,142	$ 865,124
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 33,656	$ 31,503
Accrued liabilities	107,448	88,472
Deferred revenue	24,114	17,845
Total current liabilities	165,218	137,820
Convertible senior notes, net	243,493	—
Deferred tax liability	42,995	24,298
Other liabilities	26,341	11,720
Total liabilities	478,047	173,838
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Common stock, $0.0001 par value; 100,000 shares authorized; 38,196 and 36,358 shares issued and outstanding on December 31, 2013 and December 31, 2012, respectively	4	4
Additional paid-in capital	771,875	652,110
Accumulated earnings	16,216	39,172
Total stockholders' equity	788,095	691,286
Total liabilities and stockholders' equity	$ 1,266,142	$ 865,124

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

SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)

	Year Ended December 31,		
	2013	2012	2011
Net revenues	$ 783,642	$ 640,624	$ 473,270
Cost of net revenues	369,593	294,857	219,542
Gross profit	414,049	345,767	253,728
Operating expenses:			
Technology and development	108,995	85,746	65,675
Sales and marketing	189,985	148,806	113,952
General and administrative	93,011	70,502	58,710
Total operating expenses	391,991	305,054	238,337
Income from operations	22,058	40,713	15,391
Interest expense	(9,446)	(597)	(64)
Interest and other income, net	308	42	35
Income before income taxes	12,920	40,158	15,362
Provision for income taxes	(3,635)	(17,160)	(1,314)
Net income	$ 9,285	$ 22,998	$ 14,048
Net income per share:			
Basic	$ 0.25	$ 0.64	$ 0.43
Diluted	$ 0.24	$ 0.61	$ 0.40
Weighted average shares:			
Basic	37,680	35,826	32,788
Diluted	39,493	37,432	35,007
Stock-based compensation is allocated as follows (Notes 2 and 6):			
Cost of net revenues	$ 2,485	$ 1,696	$ 2,138
Technology and development	9,477	8,635	8,201
Sales and marketing	19,774	11,559	11,350
General and administrative	21,792	15,432	12,181

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

SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Year Ended December 31,		
	2013	2012	2011
Common stock (par value)			
Balance, beginning of year	$ 4	$ 4	$ 3
Issuance of common stock in connection with acquisition and upon exercise of options and vesting of restricted stock units	1	1	1
Common stock repurchased and retired	(1)	(1)	—
Balance, end of year	4	4	4
Additional paid-in capital			
Balance, beginning of year	652,110	589,067	263,726
Issuance of common stock upon exercise of options and vesting of restricted stock units	19,112	10,210	22,277
Stock based compensation, net of estimated forfeiture	55,237	38,214	34,351
Issuance of common stock in connection with acquisition	—	—	260,322
Tax benefit of stock options	2,957	14,619	8,391
Equity component of the convertible note issuance, net	62,409	—	—
Purchase of convertible note hedge	(63,510)	—	—
Sale of warrants	43,560	—	—
Balance, end of year	771,875	652,110	589,067
Accumulated earnings			
Balance, beginning of year	39,172	19,926	5,878
Common stock repurchased and retired	(32,241)	(3,752)	—
Net income	9,285	22,998	14,048
Balance, end of year	16,216	39,172	19,926
Total stockholders' equity	$ 788,095	$ 691,286	$ 608,997
Number of shares			
Common stock			
Balance, beginning of year	36,358	34,839	27,957
Issuance of common stock upon exercise of options and vesting of restricted stock units	2,540	1,656	2,882
Common stock repurchased and retired	(702)	(137)	—
Issuance of common stock in connection with acquisition	—	—	4,000
Balance, end of year	38,196	36,358	34,839

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

SHUTTERFLY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net income	$ 9,285	$ 22,998	$ 14,048
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	43,887	29,424	22,316
Amortization of intangible assets	30,969	20,685	12,136
Amortization of debt discount and transaction costs	7,707	—	—
Stock-based compensation, net of forfeitures	53,528	37,322	33,870
(Gain) / Loss on disposal of property and equipment	13	(861)	(301)
Deferred income taxes	331	54	(5,766)
Tax benefit from stock-based compensation	2,957	14,619	8,391
Excess tax benefits from stock-based compensation	(3,635)	(16,622)	(8,380)
Changes in operating assets and liabilities:			
Accounts receivable, net	(7,174)	(577)	(7,205)
Inventories	(3,681)	(1,306)	766
Prepaid expenses and other current assets	(4,347)	(1,399)	(5,667)
Other assets	(7,669)	212	(1,402)
Accounts payable	3,583	15,230	(16,458)
Accrued and other liabilities	16,089	26,610	12,255
Deferred revenue	5,258	5,739	1,870
Other non-current liabilities	167	(747)	2,775
Net cash provided by operating activities	147,268	151,381	63,248
Cash flows from investing activities:			
Acquisition of business and intangible assets, net of cash acquired	(76,893)	(57,212)	(133,705)
Purchases of property and equipment	(62,582)	(40,535)	(23,149)
Capitalization of software and website development costs	(15,760)	(12,528)	(10,050)
Proceeds from sale of equipment	388	986	676
Net cash used in investing activities	(154,847)	(109,289)	(166,228)
Cash flows from financing activities:			
Proceeds from borrowings of convertible senior notes, net of issuance costs	291,897	—	—
Proceeds from issuance of warrants	43,560	—	—
Purchase of convertible note hedge	(63,510)	—	—
Proceeds from issuance of common stock upon exercise of stock options	19,112	10,211	22,277
Repurchases of common stock	(32,241)	(3,752)	—
Excess tax benefits from stock-based compensation	3,635	16,622	8,380
Principal payments of capital lease and financing obligations	(878)	—	(6)
Net cash provided by financing activities	261,575	23,081	30,651
Net increase (decrease) in cash and cash equivalents	253,996	65,173	(72,329)
Cash and cash equivalents, beginning of period	245,088	179,915	252,244
Cash and cash equivalents, end of period	$ 499,084	$ 245,088	$ 179,915
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	$ 466	$ —	$ —
Income taxes	2,158	618	140
Supplemental schedule of non-cash investing activities:			
Net increase (decrease) in accrued purchases of property and equipment	$ (3,372)	$ 7,694	$ 412
Estimated fair market value of building under build-to-suit leases	10,080	6,372	—
Amount due for acquisition of business	—	963	—
Amount due from adjustment of net working capital from acquired business	10	—	—

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

SHUTTERFLY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Description of Business

Shutterfly, Inc., (the "Company" or "Shutterfly") was incorporated in the state of Delaware in 1999 and began its services in December 1999. The Company is the leading manufacturer and digital retailer of high-quality personalized products and services offered through a family of lifestyle brands. The Company provides customers a full range of products and services to organize and archive digital images; share pictures; order prints and create an assortment of personalized items such as photo books, greeting cards and stationery and calendars. Shutterfly also operates a premier online marketplace for high-quality photographic and video equipment rentals. And the Company provides enterprise services: printing and shipping of direct marketing and other variable data print products and formats. The Company is headquartered in Redwood City, California.

Note 2 — The Company and Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The functional currency of its Israeli subsidiary is the U.S. Dollar, as such, exchange rate fluctuations are recorded as a part of earnings. All intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Items subject to such estimates and assumptions include, among others, intangible assets valuation, useful lives, excess and obsolete inventories, restructuring, legal contingencies, valuation allowances, provision for sales returns, and allowance for doubtful accounts. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. Management determines the appropriate classification of cash equivalents at the time of purchase and reevaluates such designations at each balance sheet date. Cash equivalents consist of money market funds, primarily invested in U.S. Treasury securities.

Fair Value

The Company records its financial assets and liabilities at fair value. The accounting standard for fair value provides a framework for measuring fair value, clarifies the definition of fair value, and expands disclosures regarding fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market

participants at the reporting date. The accounting standard establishes a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of December 31, 2013 and 2012, the Company had cash of $499.1 million and $186.3 million, respectively, and cash equivalents in 2012 of $58.8 million which are classified in the Level 1 hierarchy. The fair value of the Company's convertible senior notes is classified in the Level 2 hierarchy. The Company has no Level 3 assets or liabilities.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist principally of cash, cash equivalents, and accounts receivable. As of December 31, 2013, the Company's cash and cash equivalents were maintained by financial institutions in the United States and its deposits may be in excess of insured limits. The Company believes that the financial institutions that hold its investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The Company's accounts receivable are derived primarily from sales to customers located in the United States who make payments through credit cards, sales of the Company's products in retail stores, sales of enterprise services, and revenue generated from online advertisements posted on the Company's websites. Credit card receivables settle relatively quickly and the Company's historical experience of credit card losses have not been material and have been within management's expectations. Excluding amounts due from credit cards of customers, as of December 31, 2013, one Enterprise customer accounted for 28% of the Company's net accounts receivable. No other customers accounted for more than 10% of net accounts receivable as of December 31, 2013. As of December 31, 2012, two Enterprise customers accounted for 26% and 12% of the Company's net accounts receivable, respectively. No other customers accounted for more than 10% of net accounts receivable as of December 31, 2012.

Inventories

Inventories are stated at the lower of cost on a first-in, first-out basis or net realizable value. The value of inventories is reduced by estimates for excess and obsolete inventories. The estimate for excess and obsolete inventories is based upon management's review of utilization of inventories in light of projected sales, current market conditions and market trends. Inventories are primarily raw materials and consist principally of paper, photo book covers and packaging supplies.

Deferred Costs

Deferred costs are the incremental costs directly associated with flash deal promotions through group buying websites. These costs are paid and deferred at the time of the flash deal, and recognized when the redeemed products are shipped. Amortization of deferred costs is included in sales and marketing expense in the accompanying consolidated statements of income.

Property and Equipment

Property and equipment are stated at historical cost, less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated lives of the assets, generally three to five years, and are allocated between cost of net revenues and operating expenses. Rental assets are depreciated over their estimated useful lives, generally five to six years as component of cost of net revenues, to an estimated net realizable value. Leasehold improvements are amortized over their estimated useful lives, or the lease term if shorter, generally three to ten years. Upon retirement or sale, the cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operating expenses, except for rental assets, which are recognized in cost of net revenues. Major additions and improvements are capitalized, while replacements, maintenance and repairs that do not extend the life of the asset are charged to expense as incurred.

Software and Website Development Costs

The Company capitalizes eligible costs associated with website development and software developed or obtained for internal use. Accordingly, the Company expenses all costs that relate to the planning and post implementation phases. Payroll and payroll related costs and stock based compensation incurred in the development phase are capitalized and amortized over the product's estimated useful life, generally three years. Costs associated with minor enhancements and maintenance for the Company's websites are expensed as incurred.

Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by comparison of the carrying amount to the future net cash flows which the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the projected discounted future cash flows arising from the asset using a discount rate determined by management to be commensurate with the risk inherent to the Company's current business model.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Intangible assets resulting from the acquisition of entities accounted for using the purchase method of accounting are estimated by management based on the fair value of assets received. Intangible assets are amortized on a straight-line basis over the estimated useful lives which range from one to sixteen years, and the amortization is allocated between cost of net revenues and operating expenses. Goodwill and intangible assets with indefinite lives are not subject to amortization, but are tested for impairment on an annual basis during the fourth quarter or whenever events or changes in circumstances indicate the carrying amount of these assets may not be recoverable.

For the Company's annual goodwill impairment analysis, the Company operates under one reporting unit. The Company determined the fair value of its reporting unit based on its enterprise value. The Company performed step one of the annual goodwill impairment test for years ended December 31, 2013 and 2012. The enterprise value exceeded the carrying value for both periods and accordingly, no impairment was recorded.

Intellectual Property Prepaid Royalties

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

Lease Obligations

The Company categorizes leases at their inception as either operating or capital leases. On certain of our lease agreements, the Company may receive rent holidays and other incentives. The Company recognizes lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays that defer the commencement date of required payments. Additionally, incentives the Company receives are treated as a reduction of our costs over the term of the agreement.

The Company establishes assets and liabilities for the estimated construction costs incurred under build-to-suit lease arrangements to the extent the Company is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease. Upon occupancy of facilities under build-to-suit leases, the Company assesses whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance. If the Company continues to be the deemed owner, the facilities are accounted for as financing leases.

Revenue Recognition

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

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

For gift card sales and flash deal promotions through group buying websites, the Company recognizes revenue on a gross basis, as it is the primary obligor, when redeemed items are shipped. Revenues from sales of prepaid orders on its websites are deferred until shipment of fulfilled orders or until the prepaid period expires. The Company's share of revenue generated from its print to retail relationships, is recognized when orders are picked up by its customers at the respective retailer.

The Company provides its customers with a 100% satisfaction guarantee whereby products can be returned within a 30-day period for a reprint or refund. The Company maintains an allowance for estimated future returns based on historical data. The provision for estimated returns is included in accrued expenses.

The Company periodically provides incentive offers to its customers in exchange for setting up an account and to encourage purchases. Such offers include free products and percentage discounts on current purchases. Discounts, when accepted by customers, are treated as a reduction to the purchase price

of the related transaction and are presented in net revenues. Production costs related to free products are included in cost of revenues upon redemption.

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

Restructuring Costs

The Company records restructuring costs when expenses are incurred. The Company accrues for lease termination costs when the restructuring event takes place. The Company accrues for severance once the total severance pool has been calculated, approved and communicated, and recognizes the expense ratably over the required service period, from the communication date to the exit date. The Company also accelerates depreciation using a revised economic life of the leasehold improvement assets.

Advertising Costs

Advertising costs are expensed as incurred, except for direct mail advertising which is expensed when the advertising first takes place. The Company did not have any capitalized direct mail costs at December 31, 2013 and December 31, 2012. Total advertising costs are a component of sales and marketing expenses and include print advertising, internet advertising, such as display ads and keyword search terms and TV and radio advertising. These amounts totaled approximately $87.5 million, $69.9 million and $54.1 million during the years ended December 31, 2013, 2012 and 2011, respectively.

Stock-Based Compensation

The Company measures stock based awards at fair value and recognizes compensation expense for all share-based payment awards made to its employees and directors, including employee stock options and restricted stock awards.

The Company estimates the fair value of stock options granted using the Black-Scholes valuation model. This model requires the Company to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of the Company's common stock price and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and consequently, the related amount recognized in the Company's consolidated statements of income.

The cost of restricted stock awards and performance based restricted stock awards is determined using the fair value of the Company's common stock on the date of grant. Compensation expense is recognized for restricted stock awards on a straight-line basis over the vesting period. Compensation expense associated with performance based restricted stock awards is recognized on an accelerated attribution model, and ultimately based on whether or not satisfaction of the performance criteria is probable. If in the future, situations indicate that the performance criteria are not probable, then no further compensation cost will be recorded, and any previous costs will be reversed.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized by applying the statutory tax rates in effect in the years in which the differences between the financial reporting and tax filing bases of existing assets and liabilities are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

The Company reports a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. The Company is required to make subjective assumptions and judgments regarding its income tax exposures. Interpretations and guidance surrounding income tax laws and regulations change over time. As such, changes in the Company's subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of income.

The Company's policy is to recognize interest and /or penalties related to all tax positions in income tax expense. To the extent that accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision in the period that such determination is made. No interest and penalties were accrued as of December 31, 2013 and 2012.

The Company is subject to taxation in the United States and Israel.

Net Income Per Share

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

Diluted net income per share attributed to common shares is computed by dividing the net income attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period, if the effect of each class of potential common shares is dilutive. Potential common shares include restricted stock units and incremental shares of common stock issuable upon the exercise of stock options.

	Year ended December 31,		
	2013	2012	2011
	(in thousands, except per share amounts)		
Net income per share:			
Numerator			
Net income	$ 9,285	$ 22,998	$ 14,048
Denominator			
Denominator for basic net income per share			
Weighted-average common shares outstanding	37,680	35,826	32,788
Dilutive effect of stock options and restricted awards	1,813	1,606	2,219
Denominator for diluted net income per share	39,493	37,432	35,007
Net income per share			
Basic	$ 0.25	$ 0.64	$ 0.43
Diluted	$ 0.24	$ 0.61	$ 0.40

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

	Year ended December 31,		
	2013	2012	2011
Stock options and restricted stock units	24	748	278

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income is composed of net income. Accordingly, the accompanying consolidated statements of income reflect all changes in comprehensive income.

Segment Reporting

The Company reports as one operating segment with the Chief Executive Officer ("CEO") acting as the Company's chief operating decision maker. The Company's CEO reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. The Company has a single reporting unit and there are no segment managers who are held accountable for operations, operating results or components below the consolidated unit level.

Net revenues by Consumer and Enterprise categories were as follows:

	Year ended December 31,		
	2013	2012	2011
		(in thousands)	
Net revenues			
Consumer	$ 745,969	$ 613,445	$ 459,725
Enterprise	37,673	27,179	13,545
Total net revenues	$ 783,642	$ 640,624	$ 473,270

Recent Accounting Pronouncements

In 2013, the FASB issued a new accounting standard that will require the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the Consolidated Balance Sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new standard requires adoption on a prospective basis in the first quarter of 2015; however, early adoption is permitted. The Company does not anticipate that this adoption will have a significant impact on its financial position, results of operations, or cash flows.

Note 3 — Balance Sheet Components

Intellectual Property Prepaid Royalties

Total amortization for these license agreements in 2013 and 2012 were $1.5 million and $0.9 million, respectively. As of December 31, 2013, the Company had a balance of $9.5 million in unamortized prepaid royalties. Amortization of these licenses is estimated as follows (in thousands):

Year Ending:	
2014	$ 1,527
2015	964
2016	854
2017	799
2018	799
Thereafter	4,537
	$ 9,480

Prepaid Expenses and Other Current Assets

	December 31, 2013	December 31, 2012
	(in thousands)	
Prepaid service contracts – current portion	$ 5,044	$ 5,771
Deferred costs	4,915	3,278
Other prepaid expenses and current assets	11,301	6,219
	$ 21,260	$ 15,268

Other Assets

	December 31, 2013	December 31, 2012
	(in thousands)	
Other assets	$ 15,412	$ 4,310

Other assets includes the long-term portion of intellectual property prepaid royalties, the long-term portion of issuance costs related to the Company's 0.25% Convertible Notes, the long-term portion of prepaid service contracts, and deposits on long-term leases and other contracts. The increase during the year ended December 31, 2013 was primarily due to the addition of intellectual property prepaid royalties and issuance costs related to the Company's 0.25% Convertible Notes.

Property and Equipment

	December 31,	
	2013	2012
	(in thousands)	
Computer and manufacturing equipment	$ 182,491	$ 135,181
Software	19,719	17,342
Leasehold improvements	17,702	11,009
Buildings under build-to-suit leases	16,452	6,372
Rental equipment	11,943	—
Furniture and fixtures	8,391	4,075
Capitalized software and website development costs	66,196	49,013
	322,894	222,992
Less: Accumulated depreciation and amortization	(167,167)	(130,325)
Net property and equipment	$ 155,727	$ 92,667

Building value of $16.5 million represents the estimated fair market value of buildings under build-to-suit leases of which the Company is the "deemed owner" for accounting purposes only. See *"Note 5 — Commitments and Contingencies."*

Included within Computer and other equipment is approximately $6.8 million of capital lease obligations for various pieces of manufacturing facility and computer equipment. Accumulated depreciation of assets under capital lease totaled $0.8 million at December 31, 2013.

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

Depreciation and amortization expense totaled $43.9 million, $29.4 million, and $22.3 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Total capitalized software and website development costs, net of accumulated amortization totaled $27.8 million and $21.9 million at December 31, 2013 and 2012, respectively. Amortization of capitalized costs totaled approximately $10.8 million, $8.4 million and $5.4 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Intangible Assets

Intangible assets are comprised of the following at December 31:

	Weighted Average Useful Life	December 31, 2013	December 31, 2012
		(in thousands)	
Purchased technology	10 years	$ 104,553	$ 98,603
Less: accumulated amortization		(35,653)	(23,020)
		68,900	75,583
Customer relationships	5 years	74,576	60,466
Less: accumulated amortization		(27,452)	(14,035)
		47,124	46,431
Licenses and other	3 years	6,692	871
Less: accumulated amortization		(4,095)	(616)
		2,597	255
Total		$ 118,621	$ 122,269

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

Intangible asset amortization expense for the years ended December 31, 2013, 2012 and 2011 was $29.5 million, $19.7 million and $11.4 million, respectively. Amortization of existing intangible assets is estimated to be as follows (in thousands):

Year Ending:	
2014	$ 32,014
2015	24,980
2016	18,382
2017	13,602
2018	4,802
Thereafter	24,841
	$ 118,621

Goodwill

Changes in the carrying amount of goodwill are as follows (in thousands):

Balance, December 31, 2011	$ 340,408
Acquisition of business	17,941
Goodwill adjustments	—
Balance, December 31, 2012	358,349
Acquisition of business	38,957
Goodwill adjustments	—
Balance, December 31, 2013	$ 397,306

The increase in goodwill for the year ended December 31, 2013 was a result of the acquisitions of MyPublisher, Inc., R&R Images, Inc. and BorrowLenses LLC.

The increase in goodwill for the year ended December 31, 2012 was a result of the acquisitions of Photoccino, Ltd., Penguin Digital, Inc., and ThisLife.com, Inc.

Accrued Liabilities

	December 31,	
	2013	2012
	(in thousands)	
Accrued production costs	$ 34,525	$ 22,534
Accrued marketing expenses	26,203	21,371
Accrued income and sales tax	16,465	15,002
Accrued compensation	14,872	13,904
Accrued consulting	4,548	4,200
Accrued purchases	3,723	5,239
Capital lease obligations	1,530	—
Accrued other	5,582	6,222
	$ 107,448	$ 88,472

Other Liabilities

	December 31,	
	2013	2012
	(in thousands)	
Other liabilities	$ 26,341	$ 11,720

Other liabilities includes the long-term portion of capital lease obligations, deferred rent, and financing obligations related to the Company's build-to-suit leases. The increase during the year ended December 31, 2013 was primarily related to additions of financing obligations for the Company's Fort Mill, South Carolina and Shakopee, Minnesota production facilities and capital leases for production equipment.

Note 4 — Acquisitions

Business Combinations

BorrowLenses LLC

On October 24, 2013, the Company acquired BorrowLenses LLC ("BorrowLenses") for a total aggregate cash purchase price of $36.9 million, or $35.8 million net of cash acquired. BorrowLenses is a premier online marketplace for photographic and video equipment rentals. The acquisition was accounted for as a non-taxable purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill. For federal income tax purposes, an election was made to treat the non-taxable transaction as an asset acquisition.

Of the total purchase price, $4.2 million was allocated to the customer base, which will be amortized over an estimated useful life of four years, $1.0 million was allocated to developed technologies, which will be amortized over an estimated useful life of approximately three years, and $1.6 million was allocated to the BorrowLenses tradename, which will be amortized over an estimated useful life of four years. The assets and liabilities acquired totaled approximately $13.3 million and $0.8 million, respectively. The remaining excess purchase price of approximately $17.7 million was allocated to goodwill primarily representing the assembled workforce and synergies from BorrowLenses' market position. The results of operations for the acquired business have been included in the consolidated statement of income for the period subsequent to the Company's acquisition of BorrowLenses. BorrowLenses' results of operations for periods prior to this acquisition were not material to the consolidated statement of operations and, accordingly, pro forma financial information has not been presented.

R&R Images, Inc.

On August 29, 2013, the Company acquired certain assets of R&R Images, Inc. ("R&R") primarily to expand product innovation and printing capabilities. The acquisition was accounted for as a business combination. This acquisition was not significant individually or when aggregated with other acquisitions during the year ended December 31, 2013. The Company has included financial results of R&R in the consolidated financial statements from the acquisition date of August 29, 2013 through December 31, 2013.

MyPublisher, Inc.

On April 29, 2013, the Company acquired MyPublisher, Inc. ("MyPublisher") for a total aggregate cash purchase price of $40.4 million, or $38.6 million net of cash acquired. MyPublisher is one of the pioneers in the photo book industry and creator of easy-to-use photo book making software. The acquisition was accounted for as a non-taxable purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill.

Of the total purchase price, $9.5 million was allocated to the customer base, which will be amortized over an estimated useful life of four years, $7.8 million was allocated to developed technologies and will be amortized over an estimated useful life of approximately two years, $1.3 million to the MyPublisher tradename, which will be amortized over an estimated useful life of two years, and $0.1 million to favorable leases which will be amortized over an estimated useful life of five years. The tangible assets and liabilities acquired totaled approximately $8.2 million and $7.8 million, respectively. Included within assets and liabilities is a net deferred tax liability of approximately $0.3 million representing the difference between the assigned values of the assets acquired and the tax basis of those assets, with the offset recorded as additional goodwill. The remaining excess purchase price of approximately $21.3 million was allocated to goodwill primarily representing the assembled workforce and synergies from MyPublisher's market position. The results of operations for the acquired business have been included in the consolidated statement of income for the period subsequent to the Company's acquisition of MyPublisher. MyPublisher's results of operations for periods prior to this acquisition were not material to the consolidated statement of operations and, accordingly, pro forma financial information has not been presented.

ThisLife.com, Inc.

On December 28, 2012, the Company acquired ThisLife.com, Inc. ("ThisLife") for a total aggregate cash purchase price of $22.5 million. ThisLife provides cloud-based services for protecting, organizing, storing and sharing photos and videos which will strengthen the Company's photo storage and sharing capabilities as well as enable the creation of products across the web and mobile efficiently. The acquisition was accounted for as a non-taxable purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill. In addition, restricted stock awards were granted to certain ThisLife employees contingent upon their continued employment for a period of three years and will be recorded as stock-based compensation over the vesting period. Also, performance-based restricted stock units ("PBRSU") were granted to certain ThisLife employees contingent on achieving certain performance milestones and continued employment for a period of three years. These awards will be recorded as stock-based compensation over the vesting period.

Of the total purchase price, $14.6 million was allocated to developed technology and is being amortized over an estimated useful life of five years and $0.2 million was allocated to the active user base which will be amortized over an estimated useful life of two years. The assets and liabilities acquired totaled approximately $1.0 million and $1.2 million, respectively. The remaining excess purchase price of approximately $7.9 million was allocated to goodwill primarily representing the assembled workforce and synergies from the accelerated time to market. In addition, $4.3 million was recorded as a deferred tax liability representing the difference between the assigned values of the assets acquired and the tax basis of those assets, with the offset recorded as additional goodwill. The results of operations for the acquired business have been included in the consolidated statement of income for the period subsequent to the Company's acquisition of ThisLife. ThisLife's results of operations for periods prior to this acquisition were not material to the consolidated statement of operations and, accordingly, pro forma financial information has not been presented.

Penguin Digital, Inc.

On September 14, 2012, the Company acquired Penguin Digital, Inc. ("Penguin Digital") for a total aggregate cash purchase price of $7.1 million. Penguin Digital is a mobile application development company that has an iPhone application that allows users to access their photos from iPhones or their Facebook or Instagram accounts and create customized products and gifts from their mobile devices. The acquisition was accounted for as a non-taxable purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill. In addition, RSUs were granted to certain Penguin Digital employees contingent upon their continued employment for a period of three years. Also, PBRSUs were granted to certain Penguin Digital employees contingent on achieving certain performance milestones and continued employment for a period of three years. These awards will be recorded as stock-based compensation over the vesting period.

Of the total purchase price, $2.9 million was allocated to developed technology and is being amortized over an estimated useful life of three years, $0.9 million was allocated to in-process research and development, and $0.2 million was allocated to the active user base which will be amortized over an estimated useful life of two years. The assets and liabilities acquired totaled approximately $0.1 million and $0.2 million, respectively. The remaining excess purchase price of approximately $3.2 million was allocated to goodwill primarily representing the assembled workforce and synergies from the accelerated time to

market. In addition, $0.9 million was recorded as a deferred tax liability which represents the difference between the assigned values of the assets acquired and the tax basis of those assets offset by net operating loss carryforwards. The offset is recorded as additional goodwill. The results of operations for the acquired business have been included in the consolidated statement of income for the period subsequent to the acquisition. Penguin Digital's results of operations for periods prior to this acquisition were not material to the consolidated statement of income and, accordingly, pro forma financial information has not been presented.

Photoccino Ltd.

On May 25, 2012, the Company acquired Photoccino Ltd. ("Photoccino") for a total aggregate cash purchase price of $4.6 million. Photoccino has developed technologies for photo ranking, analysis and organization which will allow customers to more efficiently organize and select the best photos from their archives so they can quickly and easily create photo books, calendars, cards, and photo gifts. Photoccino's technology applies proprietary algorithms to analyze and evaluate the quality and content of photos, ranks them, and automatically creates photo products using the customer's best images. The acquisition was accounted for as a non-taxable purchase transaction and, accordingly, the purchase price has been allocated to the acquired tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill. In addition, restricted stock awards were granted to certain Photoccino employees contingent upon their continued employment for a period of three years and will be recorded as stock-based compensation over the vesting period.

Of the total purchase price, $3.0 million was allocated to developed technology and is being amortized over an estimated useful life of five years, $0.7 million was allocated to in-process research and development, and $80,000 was allocated to non-compete agreements with the founders which will be amortized over an estimated useful life of two years. The assets and liabilities acquired totaled approximately $0.1 million. The remaining excess purchase price of approximately $0.7 million was allocated to goodwill primarily representing the assembled workforce. In addition, $0.9 million was recorded as a deferred tax liability representing the difference between the assigned values of the assets acquired and the tax basis of those assets, with the offset recorded as additional goodwill. The results of operations for the acquired business have been included in the consolidated statement of operations for the period subsequent to the Company's acquisition of Photoccino. Photoccino's results of operations for periods prior to this acquisition were not material to the consolidated statement of operations and, accordingly, pro forma financial information has not been presented.

Tiny Prints, Inc.

On April 25, 2011, the Company acquired Tiny Prints, Inc. ("Tiny Prints"), a privately-held ecommerce company. Pursuant to the terms of the agreement, all of the outstanding shares of capital stock of Tiny Prints, together with vested and unvested Tiny Prints equity awards, were acquired by the Company for aggregate consideration comprised of (i) approximately $146.0 million in cash, and approximately 4.0 million shares of the Company's common stock issuable in exchange for shares of Tiny Prints capital stock and (ii) Company equity awards for approximately 1.4 million shares of common stock in exchange for vested and unvested Tiny Prints' equity awards assumed by the Company, in each case pursuant and subject to the terms of the Merger Agreement. The 5.4 million shares of Shutterfly common stock issuable pursuant to the agreement equal approximately 18.5% of the Company's outstanding common stock as of March 30, 2011.

Subsequent to the acquisition date, the Company finalized the Net Working Capital, Net Cash, and Net Debt amounts resulting in a reduction of purchase price of approximately $1.3 million. In accordance with the merger agreement, this amount will be repaid from the consideration held in escrow in the same proportion of cash and stock as was made in the initial escrow contribution. As of December 31, 2011, the cash proceeds due from escrow have been received and the stock has been deducted from shares outstanding.

Purchase Price

The total purchase price, after adjusting for changes in Net Working Capital, Net Cash, and Net Debt, is as follows (in thousands):

Cash consideration	$ 146,040
Fair value of common stock issued	218,557
Fair value of vested stock awards assumed	41,766
Total fair value of consideration transferred	**$ 406,363**

Tiny Prints operates tinyprints.com and weddingpaperdivas.com which offer cards, invitations, and personalized stationery. With the acquisition and combined resources, the Company expects to incur significant revenue and cost synergies through the Tiny Prints brands, customer base and workforce.

Estimated Fair Value of Stock Awards Assumed

In connection with the acquisition, each Tiny Prints stock option that was outstanding and unexercised was assumed and converted into an option to purchase the Company's common stock based on a conversion ratio of 0.327, which was calculated as the consideration price per share of $12.44 divided by a fixed per share value of $38. The Company assumed the stock options in accordance with the terms of the applicable Tiny Prints stock option plan and the stock option agreement. Based on Tiny Prints' stock options outstanding at April 25, 2011, the Company converted options to purchase approximately 4.1 million shares of Tiny Prints common stock into options to purchase approximately 1.3 million shares of the Company's common stock. The Company also assumed and converted 196,896 unvested shares of outstanding Tiny Prints restricted stock units into 64,386 shares of the Company's restricted stock units, using the same conversion ratios stated above.

The fair value of stock options assumed was calculated using a Black-Scholes valuation model with the following assumptions: closing date market price of $54.64 per share; expected term of 4.5; risk-free interest rate of 2.1%; expected volatility of 48.1%; and no dividend yield. The fair value of restricted stock units assumed was calculated using the closing date market price of $54.64 per share for the Company's common stock. The Company included the fair value of vested stock options assumed of $41.8 million in the consideration transferred for the acquisition. The estimated fair value of unvested stock options and restricted stock units assumed by the Company of $25.8 million was not included in the consideration transferred and is being recognized as stock-based compensation expense over the weighted average remaining vesting period of approximately two years. In addition, the Company determined that $2.9 million of incremental fair value was associated with vested awards at the acquisition date, and has recognized this additional amount in its post-combination financial statements as stock-based compensation.

Purchase Price Allocation

Under the purchase accounting method, the total purchase price was allocated to Tiny Prints' tangible and identifiable intangible assets acquired and liabilities assumed based upon their estimated fair values as of the April 25, 2011 closing date of the acquisition. The excess purchase price over the value of the net assets acquired is recorded as goodwill.

The purchase price of Tiny Prints is allocated as follows (in thousands):

	Amount	Estimated Useful Life (in years)
Total assets acquired	$ 19,235	N/A
Total liabilities assumed	(42,097)	N/A
Identifiable intangible assets:		
Trade name	51,100	15
Customer base	33,300	7
Developed technology	12,500	4
Other	3,080	2-3
Goodwill	329,245	N/A
Total purchase price	$ 406,363	

Initially, included in the total liabilities assumed was a net deferred tax liability balance of $32.2 million, primarily comprised of the difference between the assigned values of the tangible and intangible assets acquired and the tax basis of those assets. This amount is net of deferred tax assets related to vested non-qualified stock options included in the purchase price, as well as other deferred tax assets acquired in the transaction. Subsequent to recording the transaction, and upon filing of the Tiny Prints tax returns, the Company reduced its estimate of acquired deferred tax liabilities by $2.0 million, with an offsetting reduction in goodwill. This resulted in an adjusted net deferred tax liability balance of $30.2 million.

Amortizable intangible assets total $100.0 million and consist of trade name, customer base, developed technology, and other contractual agreements with useful lives that range from 2 to 15 years.

Goodwill of $329.2 million represents the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets, and represents the expected synergistic benefits of the transaction and the knowledge and experience of the workforce in place. In accordance with applicable accounting standards, goodwill will not be amortized but instead will be tested for impairment at least annually, or, more frequently if certain indicators are present. In the event that the management of the combined company determined that the value of goodwill has become impaired, the combined company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made.

Acquisition-related costs were included in general and administrative expenses in the Company's consolidated statement of operations for the year ended December 31, 2011.

The following table presents the pro forma statements of income obtained by combining the historical consolidated operations of the Company and Tiny Prints for the year ended December 31, 2011 and 2010,

giving effect to the merger as if it occurred on January 1, 2011 and 2010, respectively (in thousands, except per share data):

	Year Ended December 31, 2011
Pro forma net revenues	$ 499,048
Pro forma net income	11,089
Pro forma diluted net income per share	$ 0.32

Included in net revenues for the year ended December 31, 2011 is $93.0 million of net revenues from sales of Tiny Prints products from the acquisition date of April 25, 2011 through December 31, 2011.

Purchased Intangible Assets

Eastman Kodak Gallery Assets

On March 1, 2012, the Company entered into an agreement with Kodak for the proposed sale of certain assets of its Kodak Gallery online photo services business for $23.8 million through a court-supervised auction process. On April 30, 2012, the transaction was approved by the bankruptcy court and on May 2, 2012 the transaction closed. The Company paid $19.0 million at close and the remaining $4.8 million at the end of the transition period, which was during 2012. This acquisition was accounted for as an asset acquisition and as such the Company has capitalized transaction costs of approximately $0.6 million, for a total purchase price of $24.4 million. The purchase price was allocated to a single asset, customer list, which will be amortized over its estimated useful life of four years.

Note 5 — Commitments and Contingencies

Leases

The Company leases office and production space under various non-cancelable operating leases that expire no later than January 2023. Rent expense was $5.8 million, $4.8 million and $4.2 million, for the years ended December 31, 2013, 2012 and 2011, respectively. In 2010, the Company renewed the lease for its corporate office. The lease renewal provided for a $2.1 million tenant improvement reimbursement allowance which the Company utilized during 2011. Reimbursements under this provision were recorded as a deferred lease incentive and will reduce rent expense over the remaining lease term.

Rent expense is recorded on a straight-line basis over the lease term. When a lease provides for fixed escalations of the minimum rental payments, the difference between the straight-line rent charged to expense, and the amount payable under the lease is recognized as deferred rent.

The Company also has non-cancelable operating leases for certain production equipment with terms ranging from four to five years. As of December 31, 2013, the total outstanding obligation under all equipment operating leases was $34.6 million.

At December 31, 2013, the total future minimum payments under non-cancelable operating and capital leases are as follows (in thousands):

	Operating Leases	Capital Leases
Year Ending:		
2014	$ 17,863	$ 1,731
2015	16,620	1,582
2016	13,330	1,412
2017	8,177	1,136
2018	3,394	693
Thereafter	3,475	—
Total minimum lease payments	$ 62,859	6,554
Less: amount representing interest		(494)
Present value of future minimum lease payments		6,060
Less: current portion		(1,530)
Non-current portion of capital lease obligations		$ 4,530

Purchase obligations consist of non-cancelable marketing and service agreements and co-location services that expire at various dates through the year 2020. As of December 31, 2013, the Company's purchase obligations totaled $100.6 million.

Build-to-suit Lease

During the year ended December 31, 2012, the Company executed a lease for a new 300,000 square foot east coast production and customer service facility in Fort Mill, South Carolina. This facility replaces the Company's current east coast production facility in Charlotte, North Carolina. In order for the facility to meet the Company's operating specifications, both the landlord and the Company made structural changes as part of the uplift of the building, and as a result, the Company has concluded that it was the "deemed owner" of the building (for accounting purposes only) during the construction period. Accordingly, at lease inception, the Company recorded an asset of $4.9 million, representing its estimate of the fair market value of the building, and a corresponding construction financing obligation, recorded as a component of other non-current liabilities. The Company increased the asset and financing obligations by $3.1 million and $1.5 million for building uplift costs incurred by the landlord during 2013 and 2012, respectively.

During the year ended December 31, 2013, the Company executed a lease for a new 217,000 square foot production facility in Shakopee, Minnesota. This facility will provide additional production capacity, and is expected to become operational in the second quarter of 2014. Both the landlord and the Company will incur costs to construct the facility according to the Company's operating specifications, and as a result, the Company has concluded that it is the "deemed owner" of the building (for accounting purposes only) during the construction period. During the year ended December 31, 2013, the landlord incurred $7.0 million of building construction costs which the Company has recorded as an asset, with a corresponding construction financing obligation, which is recorded as a component of other non-current liabilities. The Company will increase the asset and financing obligation as additional building uplift costs are incurred by the landlord during the construction period.

Also during the year ended December 31, 2013 the Company executed a lease for a new 217,000 square foot production facility in Tempe, Arizona. This facility will consolidate all of the Company's locations in the greater Phoenix area, including the recently acquired R&R Images facility, as well as offer flexibility for future expansion, and is expected to become operational during 2015. Both the landlord and the Company will incur costs to construct the facility according to the Company's operating specifications, and as a result, the Company has concluded that it is the "deemed owner" of the building (for accounting purposes only) during the construction period. As of December 31, 2013, construction had not yet begun, and no amounts have been recorded. The Company will record the asset and financing obligation as building uplift costs are incurred by the landlord during the construction period which we expect will begin in 2014.

Upon completion of construction of these facilities, the Company evaluates the de-recognition of the asset and liability under the provisions of ASC 840.40 Leases — Sale-Leaseback Transactions. However, if the Company does not comply with the provisions needed for sale-leaseback accounting, the lease will be accounted for as a financing obligation and lease payments will be attributed to (1) a reduction of the principal financing obligation; (2) imputed interest expense; and (3) land lease expense (which is considered an operating lease and a component of cost of goods sold) representing an imputed cost to lease the underlying land of the facility. In addition, the underlying building asset will be depreciated over the building's estimated useful life which is generally 30 years. And at the conclusion of the lease term, the Company would de-recognize both the net book values of the asset and financing obligation.

Construction of the Fort Mill, South Carolina facility was completed in the second quarter of 2013, and at that time the Company concluded that it had forms of continued economic involvement in the facility. As a result, the Company did not comply with provisions for sale-leaseback accounting and the building is being accounted for as a financing obligation.

Indemnifications

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because it involves future claims that may be made against the Company, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations.

Contingencies

From time to time, the Company may have certain contingent liabilities that arise in the ordinary course of its business activities. The Company accrues contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated.

Syndicated Credit Facility

On November 22, 2011, the Company entered into a credit agreement ("Credit Agreement") with J.P. Morgan Securities LLC, Wells Fargo Securities, LLC, Fifth Third Bank, Silicon Valley Bank, US Bank and Citibank, N.A. ("the Banks"). JPMorgan Chase Bank, N.A. acted as administrative agent in the Credit Agreement. The Credit Agreement is for 5 years and provides for a $125.0 million senior secured revolving credit facility (the "credit facility") and if requested by the Company, the Banks may increase the credit facility by $75.0 million subject to certain conditions. In December 2013, the Company requested and received the entire incremental amount for a total credit facility of $200.0 million. As part of the expansion, Bank of America, N.A. and Morgan Stanley Bank, N.A. joined the syndicate. From inception through December 31, 2013, the Company has not drawn on the credit facility.

At the Company's option, loans under the Facility will bear stated interest based on the Base Rate or Adjusted LIBO Rate, in each case plus the Applicable Rate (respectively, as defined in the Credit Agreement). The Base Rate will be, for any day, the highest of (a) 1/2 of 1% per annum above the Federal Funds Effective Rate (as defined in the Credit Agreement), (b) JPMorgan Chase Bank's prime rate and (c) the Adjusted LIBO Rate for a term of one month plus 1.00%. Eurodollar borrowings may be for one, two, three or six months (or such period that is 12 months or less, requested by Intersil and consented to by all the Lenders) and will be at an annual rate equal to the period-applicable Eurodollar Rate plus the Applicable Rate. The Applicable Rate for all revolving loans is based on a pricing grid ranging from 0.500% to 1.25% per annum for Base Rate loans and 1.50% to 2.250% for Adjusted LIBO Rate loans based on the Company's Leverage Ratio (as defined in the Credit Agreement).

On May 10, 2013, the Company amended the Credit Agreement by and among the Company and the Banks to (i) permit the issuance of the Notes and the related Note Hedge and Warrant, (ii) amend certain of the restrictive covenants set forth in the Credit Agreement, (iii) increase the Leverage Ratio (as defined the Credit Agreement) to be maintained by the Company to be at or below 3.50 to 1.00, and (iv) add a covenant requiring that the Company not permit its Senior Secured Leverage Ratio (as defined in the Credit Agreement) to exceed 1.60 to 1.00. Unchanged from the initial credit agreement, the Credit Agreement contains customary representations and warranties, affirmative and negative covenants, and events of default. Also, the Company may not permit the ratio of its Consolidated EBITDA for any period of four consecutive fiscal quarters to its interest and rental expense and the amount of scheduled principal payments on long-term debt, for the same period, to be less than 2.50 to 1.00. As of December 31, 2013, the Company is in compliance with all of its covenants.

Amounts repaid under the Facility may be reborrowed. The revolving loan facility matures on the fifth anniversary of its closing and is payable in full upon maturity. The Company intends to use the new Facility from time to time for general corporate purposes, working capital and potential acquisitions.

The Company incurred $0.5 million of Credit Facility origination costs during the twelve months ended December 31, 2013, related to the amendment and extension of the agreement. These costs have been capitalized within prepaid expenses for the current portion and other assets for the non-current portion. These fees are being amortized over the remaining term of the Credit Facility as a component of interest expense.

Legal Matters

The Company routinely is involved in a number of judicial and administrative proceedings that are incidental to their business. Although adverse decisions (or settlements) may occur in one or more of these cases, it is not possible to estimate the possible loss or losses from each of these cases. The final resolution of these lawsuits, individually or in the aggregate, is not expected to have a material adverse effect on the Company's business, financial position or results of operations. Cases that previously were disclosed may no longer be described because of rulings in the case, settlements, changes in our business or other developments rendering them, in our judgment, no longer material to our business, financial position or results of operations.

In all cases, at each reporting period, the Company evaluates whether or not a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses accounting for contingencies. In such cases, the Company accrues for the amount, or if a range, the Company accrues the low end of the range as a component of legal expense. The Company monitors developments in these legal matters that could affect the estimate the Company had

previously accrued. There are no amounts accrued which the Company believes would be material to its financial position and results of operations.

Note 6 — Stock-Based Compensation

1999 Stock Plan

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

2006 Equity Incentive Plan

In June 2006, the Board adopted, and in September 2006 the Company's stockholders approved, the 2006 Equity Incentive Plan (the "2006 Plan"), and all shares of common stock available for grant under the 1999 Plan transferred to the 2006 Plan. The 2006 Plan provides for the grant of ISOs to employees (including officers and directors who are also employees) of the Company or of a parent or subsidiary of the Company, and for the grant of all other types of awards to employees, officers, directors, consultants, independent contractors and advisors of the Company or any parent or subsidiary of the Company, provided such consultants, independent contractors and advisors render bona-fide services not in connection with the offer and sale of securities in a capital-raising transaction. Other types of awards under the 2006 Plan include NSOs, restricted stock awards, stock bonus awards, restricted stock units, and performance shares.

Options issued under the 2006 Plan are generally for periods not to exceed 10 years and are issued at the fair value of the shares of common stock on the date of grant as determined by the Board. The fair value of the Company's common stock is determined by the last sale price of such stock on the NASDAQ Global Select Market. Options issued under the 2006 Plan typically vest with respect to 25% of the shares one year after the options' vesting commencement date, and the remainder ratably on a monthly basis over the following three years.

The 2006 Plan provides for automatic increases in the maximum number of shares available for issuance on January 1, 2011, 2012, and 2013 by 3.5%, 3.3%, and 3.1%, respectively, of the number of shares of the Company's common stock issued and outstanding on the December 31 immediately prior to the date of increase and for automatic increases on January 1, 2014 and January 1, 2015 by 1,200,000 shares of the Company's common stock.

Tiny Prints 2008 Equity Incentive Plan

In April 2011, in connection with the acquisition of Tiny Prints, the Company converted and assumed the equity awards granted under the Tiny Prints 2008 Equity Incentive Plan (the "Tiny Prints Plan") (*See Note 4 — Acquisitions*). Awards granted under the Tiny Prints Plan include ISO, NSO, and restricted share awards, all of which generally vest with respect to 25% of the shares one year after the options' vesting commencement date, and the remainder ratably on a monthly basis over the following three years. Options under this plan will expire if not exercised within 10 years from the date of grant, and options and awards will expire if forfeited due to termination.

Stock Option Activity

A summary of the Company's stock option activity at December 31, 2013 and changes during the period are presented in the table below (share numbers and aggregate intrinsic values in thousands):

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Contractual Term (Years)	Aggregate Intrinsic Value
Balances, December 31, 2012	2,034	$ 17.09		
Granted	2	32.99		
Exercised	(1,355)	14.10		
Forfeited, canceled or expired	(65)	22.87		
Balances, December 31, 2013	616	$ 23.10	5.6	$ 17,234
Options vested and expected to vest at December 31, 2013	602	$ 22.91	5.5	$ 16,984
Options vested at December 31, 2013	462	$ 20.22	4.8	$ 14,253

As of December 31, 2012 and 2011, there were 1,677,000 and 2,188,000 options vested, respectively.

During the year ended December 31, 2013, the Company granted stock options to purchase an aggregate of 2,000 shares of common stock with a weighted average grant-date fair value of $12.55 per share. In fiscal years ended December 31, 2012 and 2011, the Company granted stock options to purchase an aggregate of 139,000 and 197,000 shares of common stock, respectively, with a weighted average grant-date value of $12.93 and $20.32 per share, respectively.

The total intrinsic value of options exercised during the twelve months ended December 31, 2013, 2012 and 2011 was $41.5 million, $12.3 million and $78.6 million, respectively. Net cash proceeds from the exercise of stock options were $19.1 million for the twelve months ended December 31, 2013.

Valuation of Stock Options

The Company estimated the fair value of each option award on the date of grant using the Black-Scholes option-pricing model and the assumptions noted in the following table. The Company calculated volatility using an average of its historical and implied volatilities as it had sufficient public trading history to cover the entire expected term. The expected term of options gave consideration to historical exercises, post vest cancellations and the options contractual term. The risk-free rate for the expected term of the

option is based on the U.S. Treasury Constant Maturity at the time of grant. The assumptions used to value options granted during the twelve months ended December 31, 2013, 2012, and 2011, were as follows:

	Year Ended December 31,		
	2013	2012	2011
Dividend yield	—	—	—
Annual risk free rate of return	0.8%	0.8%	1.5%
Expected volatility	47.0%	56.5%	53.3%
Expected term (years)	4.2	4.3	4.3

Employee stock-based compensation expense recognized during the years ended December 31, 2013 and 2012 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Restricted Stock Units

The Company grants restricted stock units ("RSUs") to its employees under the provisions of the 2006 Plan and inducement awards to certain new employees upon hire in accordance with NASDAQ Listing Rule 5635(c)(4). The cost of RSUs is determined using the fair value of the Company's common stock on the date of grant. RSUs typically vest and are settled annually, based on a three or four year total vesting term. Compensation cost is amortized on a straight-line basis over the requisite service period.

Restricted Stock Unit Activity

A summary of the Company's restricted stock unit activity for the twelve months ended December 31, 2013, is as follows (share numbers in thousands):

	Number of Units Outstanding	Weighted Average Grant Date Fair Value
Awarded and unvested, December 31, 2012	3,252	$ 31.10
Granted	1,996	45.43
Vested	(1,184)	29.89
Forfeited	(202)	36.67
Awarded and unvested, December 31, 2013	3,862	$ 38.59
Restricted stock units expected to vest, December 31, 2013	3,441	

The chart below summarizes grant activity during the twelve months ended December 31, 2013 by equity plan (share numbers in thousands):

	Grants in 2013
2006 Equity Incentive Plan	
Restricted stock units(1)	1,333
Performance-based restricted stock units(2)	355
Total grants under 2006 Plan	1,688
Inducement Plans	
Restricted stock units(3)	308
Performance-based restricted stock units	—
Total grants under Inducement Plans	308
Total awards granted in 2013	1,996

(1) Awards issued under the 2006 Plan include restricted stock unit awards granted to new and current employees. Awards issued under this plan typically vest over a three or four year total vesting term.

(2) Includes 355,000 performance-based restricted stock units (PBRSUs) issued under the 2006 Equity Incentive Plan which are tied to the Company's 2013 financial performance and which have three year service criteria. Compensation cost associated with these PBRSUs is recognized on an accelerated attribution model and ultimately based on whether or not satisfaction of the performance criteria is probable. As of December 31, 2013, the performance criteria for the fiscal year was met and the associated stock-based compensation has been recognized.

(3) Inducement awards are issued to newly hired officers and to certain new employees from acquired companies. These awards typically vest annually over a two to three year period based on continued employment. The above includes 308,000 RSUs granted to certain employees of R&R Images and BorrowLenses.

During the years ended December 31, 2013 and 2012, the fair value of awards vested were $35.9 million and $20.5 million, respectively.

At December 31, 2013, the Company had $96.1 million of total unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options and RSUs that will be recognized over a weighted-average period of approximately two years.

Note 7 — Income Taxes

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

	Year Ended December 31,		
	2013	2012	2011
United States	$ 12,570	$ 40,024	$ 15,362
Foreign	350	134	—
Total	$ 12,920	$ 40,158	$ 15,362

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

	December 31,		
	2013	2012	2011
Federal:			
Current	$ 1,181	$ 14,605	$ 5,800
Deferred	1,870	(316)	(3,095)
	3,051	14,289	2,705
State:			
Current	1,711	2,383	1,280
Deferred	(1,234)	455	(2,671)
	477	2,838	(1,391)
Foreign:			
Current	412	118	—
Deferred	(305)	(85)	—
	107	33	—
Total income tax expense (benefit):			
Current	3,304	17,106	7,080
Deferred	331	54	(5,766)
	$ 3,635	$ 17,160	$ 1,314

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

	December 31,		
	2013	2012	2011
Income tax expense at statutory rate	35.0%	35.0%	34.0%
State income taxes	(4.5)	0.9	(7.7)
Stock-based compensation	(15.2)	1.1	(13.5)
R&D tax credit	(17.1)	—	(7.2)
Acquisition costs	—	—	3.0
Non-deductible executive compensation	20.6	—	—
Valuation allowance	8.0	5.5	—
Other	1.3	0.2	—
	28.1%	42.7%	8.6%

At December 31, 2013, the Company had approximately $39.9 million, $46.3 million, and $16.0 million of federal, California and other state jurisdictions net operating loss carryforwards, respectively, to reduce future taxable income. $27.7 million, $33.8 million, and $2.0 million of the Federal, California, and other state jurisdiction net operating loss carryforwards is associated with windfall tax benefits and will be recorded as additional paid-in capital when realized. These carryforwards will expire beginning in the year 2020 and 2016 for federal and California purposes, respectively, and no sooner than 2020 for the portion related to other state jurisdictions, if not utilized.

The Company also had research and development credit carryforwards of approximately $7.2 million and $7.2 million for federal and state income tax purposes, respectively, at December 31, 2013, of which $5.4 million and $2.4 million is associated with windfall tax benefits for federal and state income tax

purposes, respectively, that will be recorded as additional paid-in capital when realized. The research and development credits may be carried forward over a period of 20 years for federal tax purposes, indefinitely for California tax purposes, and 15 years for Arizona purposes. The research and development tax credit will expire starting in 2022 for federal and 2024 for Arizona.

Internal Revenue Code limits the use of net operating loss and tax credit carryforwards in the case of an "ownership change" of a corporation. Any ownership changes, as defined, may restrict utilization of carryforwards.

On January 2, 2013, President Barack Obama signed into law The American Taxpayer Relief Act of 2012, which reinstated the research tax credit retroactive to January 1, 2012 and extended the credit through December 31, 2013. As a result of the new legislation, the Company recognized a $0.8 million for 2012 tax benefit in the year end December 31, 2013.

The components of the net deferred tax assets as of December 31, 2013 and 2012 are as follows (in thousands):

	December 31,	
	2013	2012
Deferred tax assets:		
Net operating loss carryforwards	$ 4,994	$ 2,917
Reserves and other tax benefits	30,704	22,527
Tax credits	5,296	2,415
Other	—	13
Deferred tax assets	40,994	27,872
Valuation allowance	(2,872)	(2,203)
Net deferred tax assets	38,122	25,669
Deferred tax liabilities:		
Depreciation and amortization	(53,655)	(41,400)
Net deferred tax assets / (liabilities)	$ (15,533)	$ (15,731)

Realization of deferred tax assets is dependent upon the generation of future taxable income, if any, the timing and amount of which are uncertain. Our valuation allowance related to deferred income taxes was $2.9 million as of December 31, 2013 and $2.2 million as of December 31, 2012. The increase in the valuation allowance was attributed to the Company's continued belief that it will not be able to utilize certain California deferred tax assets.

As of December 31, 2013, the Company had $7.0 million of unrecognized tax benefits. A reconciliation of the beginning and ending amounts of unrecognized income tax benefits is as follows (in thousands):

	2013	2012	2011
Balance of unrecognized tax benefits at January 1	$ 5,445	$ 4,364	$ 2,955
Additions for tax positions of prior years	22	137	—
Additions for tax positions related to current year	1,811	1,009	1,409
Reductions for tax positions of prior years	(243)	(65)	—
Balance of unrecognized tax benefits at December 31	$ 7,035	$ 5,445	$ 4,364

If the $7.0 million of unrecognized tax benefits as of December 31, 2013 is recognized, approximately $4.0 million would decrease the effective tax rate in the period in which each of the benefits is recognized. The remaining amount would be offset by the reversal of related deferred tax assets on which a valuation allowance is placed. The Company does not expect any material changes to its unrecognized tax benefits within the next twelve months.

The Company provides for federal income taxes on the earnings of its foreign subsidiary, as such, earnings are currently recognized as US taxable income.

As of December 31, 2013, the Company is subject to taxation in the United States and Israel. The Company is subject to examination for tax years including and after 2010 for federal, 2009 for California and other state jurisdictions, and 2011 for Israel. Certain tax years outside the normal statute of limitation remain open to audit by tax authorities due to tax attributes generated in those early years which have been carried forward and may be audited in subsequent years when utilized.

The Company is currently under audit by the Internal Revenue Service (IRS) for the tax year ended December 31, 2010 and California Franchise Tax Board (FTB) for the tax years ended December 31, 2010 and 2011. The Company is not aware of any proposed adjustments and it believes that the final outcome of these examinations or agreements will not have a material effect on its results of operations as of December 31, 2013.

Note 8 — Employee Benefit Plan

In 2000, the Company established a 401(k) plan under the provisions of which eligible employees may contribute an amount up to 50% of their compensation on a pre-tax basis, subject to IRS limitations. The Company matches employees' contributions at the discretion of the Board.

In 2013 and 2012, there were no discretionary contributions.

Note 9 — Share Repurchase Program

On October 24, 2012, the Company's Board of Directors conditionally authorized a share repurchase program of the Company's common stock subject to the approval of the Audit Committee of the Board of Directors. On October 29, 2012, the Audit Committee approved a share repurchase program for up to $60.0 million of the Company's common stock. The share repurchase authorization, which is effective immediately, permits the Company to effect repurchases for cash from time to time through open market, privately negotiated or other transactions, including pursuant to trading plans established in accordance with Rules 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended, or by a combination of such methods. The repurchase program does not obligate the Company to repurchase any dollar amount or number of shares and the program may be suspended or discontinued at any time. As of December 31, 2013, the remaining authorized amount for stock repurchases under the share repurchase program was $54.0 million.

In 2013, the Company repurchased 70,313 shares of its outstanding common stock at an average of $31.87 per share pursuant to the share repurchase program. In 2012, the Company repurchased 137,262 shares of its outstanding common stock at an average of $27.34. All repurchased shares of common stock have been retired.

In the second quarter of 2013, the company repurchased 631,180 shares from purchases of our 0.25% senior convertible notes in privately negotiated transactions of outside our share repurchase program using $30.0 million of the net proceeds of our issuance of the notes.

Note 10 — Convertible Senior Notes

0.25% Convertible Senior Notes Due May 15, 2018

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

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

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

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

- during any calendar quarter commencing after the calendar quarter ending on September 30, 2013 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

- during the five business day period after any ten consecutive trading day period (the "Notes Measurement Period") in which the "trading price" (as the term is defined in the Indenture) per $1,000 principal amount of notes for each trading day of such Notes Measurement Period was less than 98% of the product of the last reported sale price of the Company's common stock on such trading day and the conversion rate on each such trading day;

- upon the occurrence of specified corporate events; or

- at any time on or after December 15, 2017 until the close of business on the second scheduled trading immediately preceding the maturity date.

As of December 31, 2013, the Notes are not yet convertible.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount ("debt discount") is amortized to interest expense over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the Note issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Issuance costs attributable to the liability component, totaling $6.4 million, are being amortized to expense over the term of the Notes, and issuance costs attributable to the equity component, totaling $1.7 million, were netted with the equity component in stockholders' equity. Additionally, the Company recorded a deferred tax asset of $0.6 million on a portion of the equity component transaction costs which are deductible for tax purposes.

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

The Notes consist of the following (in thousands):

	As of December 31, 2013
Liability component:	
Principal	$ 300,000
Less: debt discount, net of amortization	(56,507)
Net carrying amount	$ 243,493
Equity component(1)	$ 63,510

(1) Recorded in the consolidated balance sheets within additional paid-in capital, net of the $1.7 million issuance costs in equity.

The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Year Ended December 31, 2013
0.25% coupon	$ 469
Amortization of debt issuance costs	705
Amortization of debt discount	7,002
	$ 8,176

As of December 31, 2013, the fair value of the Notes, which was determined based on inputs that are observable in the market or that could be derived from, or corroborated with, observable market data, including our stock price, interest rates and credit spread, (Level 2) and carrying value of debt instruments

(carrying value excludes the equity component of the Company's convertible notes classified in equity) were as follows:

	December 31, 2013		December 31, 2012	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Convertible Senior Notes	$ 237,066	$ 243,493	—	—

Note Hedge

To minimize the impact of potential economic dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock (the "Note Hedge"). In May 2013, the Company paid an aggregate amount of $63.5 million for the Note Hedge. The Note Hedge will expire upon maturity of the Notes. The Note Hedge is intended to offset the potential dilution upon conversion of the Notes and/or offset any cash payments the Company is required to make in excess of the principal amount upon conversion of the Notes in the event that the market value per share of the Company's common stock, as measured under the Notes, is greater than the strike price of the Note Hedge, which initially corresponds to the conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the Notes.

Warrant

Separately, in May 2013, the Company entered into warrant transactions (the "Warrant"), whereby the Company sold warrants to acquire shares of the Company's common stock at a strike price of $83.18 per share. The Company received aggregate proceeds of $43.6 million from the sale of the Warrant. If the average market value per share of the Company's common stock for the reporting period, as measured under the Warrant, exceeds the strike price of the Warrant, the Warrant will have a dilutive effect on the Company's earnings per share. The Warrant is a separate transaction, entered into by the Company and is not part of the Notes or the Note Hedge, and has been accounted for as part of additional paid-in capital. Holders of the Notes and Note Hedge will not have any rights with respect to the Warrant.

Note 11 — Related Party Transactions

Shutterfly's Chief Executive Officer, Jeffrey Housenbold, was appointed to Groupon, Inc.'s ("Groupon") Board of Directors effective October 21, 2013 ("Effective Date"). During the fiscal year ended December 31, 2013, Shutterfly conducted business with Groupon, primarily by offering Shutterfly's products as part of Groupon's Flash deals.

During the period between the Effective Date and December 31, 2013, Shutterfly received approximately $0.6 million from Groupon which represents our portion of proceeds from these Flash deals. As of December 31, 2013, the Company had a receivable balance of approximately $0.8 million. Management believes that these transactions are at arm's length and on similar terms as would have been obtained from unaffiliated third parties.

Note 12 — Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for the years ended December 31, 2013 and 2012 are as follows (in thousands, except per share amounts):

	Year Ended December 31, 2013			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenues	$ 116,708	$ 133,461	$ 122,685	$ 410,788
Gross profit	$ 54,855	$ 61,745	$ 51,377	$ 246,072
Net income (loss)	$ (12,405)	$ (11,811)	$ (10,148)	$ 43,649
Net income (loss) per common share:				
Basic	$ (0.33)	$ (0.31)	$ (0.27)	$ 1.15
Diluted	$ (0.33)	$ (0.31)	$ (0.27)	$ 1.10

	Year Ended December 31, 2012			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenues	$ 91,291	$ 99,020	$ 98,536	$ 351,777
Gross profit	$ 41,238	$ 48,310	$ 43,407	$ 212,812
Net income (loss)	$ (10,040)	$ (9,511)	$ (10,478)	$ 53,027
Net income (loss) per common share:				
Basic	$ (0.29)	$ (0.27)	$ (0.29)	$ 1.46
Diluted	$ (0.29)	$ (0.27)	$ (0.29)	$ 1.40

Note 13 — Subsequent Event

On February 6, 2014, the Company's Board of Directors approved an increase to repurchase up to $100.0 million in addition to amounts repurchased to date. The share repurchase authorization, which is effective immediately, permits the Company to effect repurchases for cash from time to time through open market, privately negotiated or other transactions, including pursuant to trading plans established in accordance with Rules 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended, or by a combination of such methods. The share repurchase program is subject to prevailing market conditions and other considerations; does not require Shutterfly to repurchase any dollar amount or number of shares; and may be suspended or discontinued at any time. The program now expires in April 2015.

Schedule II
Valuation and Qualifying Accounts

	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Deductions	Balance at End of Period
			In thousands		
Allowance for Doubtful Accounts Receivable					
Year ended December 31, 2011	$ 155	259	—	(80)	$ 334
Year ended December 31, 2012	$ 334	303	—	(406)	$ 231
Year ended December 31, 2013	$ 231	(140)	—	(79)	$ 12
Tax Valuation Allowance					
Year ended December 31, 2011	$ —	—	—	—	$ —
Year ended December 31, 2012	$ —	2,203	—	—	$ 2,203
Year ended December 31, 2013	$ 2,203	1,049	—	(380)	$ 2,872

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

Not applicable.

ITEM 9A. *CONTROLS AND PROCEDURES.*

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2013. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, ("Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this annual report on Form 10-K. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2013, our disclosure controls and procedures were effective at the reasonable assurance level.

Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15(d)-15(f) under the Exchange Act. The Company's internal control over financial reporting is a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may change over time.

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework (1992), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2013.

The Company reviewed the results of management's assessment with the Audit Committee of the Board of Directors. The effectiveness of the Company's internal control over financial reporting as of December 31, 2013 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2013 that materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

Limitation on Effectiveness of Controls

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

ITEM 9B. ***OTHER INFORMATION***

None.

PART III

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

The information concerning our directors required by this Item is incorporated by reference to the section in our Proxy Statement entitled "Proposal No. 1 — Election of Directors."

The information concerning our executive officers required by this Item is incorporated by reference to the section in our Proxy Statement entitled "Executive Officers."

The information concerning compliance with Section 16(a) of the Securities Exchange Act of 1934 required by this Item is incorporated by reference to the section in our Proxy Statement entitled "Section 16(a) Beneficial Ownership Reporting Compliance."

We have adopted a written code of ethics for financial employees that applies to our principal executive officer, principal financial officer, principal accounting officer, controller and other employees of the finance department designated by the Company's Chief Financial Officer. This code of ethics, titled the "Code of Conduct and Ethics for Chief Executive Officer and Senior Financial Department Personnel," can be found on our website at www.shutterfly.com. We intend to make all required disclosures concerning any amendments to, or waivers from, our code of ethics on our website.

The information concerning material changes to the procedures by which stockholders may recommend nominees to the Board of Directors required by this Item, if any, is incorporated by reference to information set forth in the Proxy Statement, in the section entitled "Information Regarding the Board of Directors and its Committees."

The information concerning the audit committee of the Board of Directors and the audit committee financial experts required by this Item is incorporated by reference to information set forth in the Proxy Statement, in the section entitled "Information Regarding the Board of Directors and its Committees."

ITEM 11. *EXECUTIVE COMPENSATION.*

The information required by this Item with respect to executive compensation, risk management and the compensation committee of the Board of Directors is incorporated by reference to information set forth in the Proxy Statement in the sections entitled "Executive Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report."

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

The information required by this Item is incorporated by reference to information set forth in the Proxy Statement in the sections entitled "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information."

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

The information concerning certain relationships and related transactions required by this Item is incorporated by reference to information set forth in the Proxy Statement in the section entitled "Certain Transactions."

The information required by this Item with respect to director independence is incorporated by reference to information set forth in the Proxy Statement in the section entitled "Independence of Board of Directors and its Committees."

ITEM 14. *PRINCIPAL ACCOUNTING FEES AND SERVICES.*

The information concerning principal accounting fees and services required by this Item is incorporated by reference to the section in our Proxy Statement entitled "Ratification of Selection of Independent Registered Public Accounting Firm."

PART IV

ITEM 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULE.*

(a) The following documents are filed as part of this annual report on Form 10-K:

1. *Financial Statements.* The consolidated financial statements of Shutterfly, Inc. are incorporated by reference to Part II, Item 8 of this annual report on Form 10-K.

2. *Financial Statement Schedule.* The Valuation and Qualifying Accounts schedule is incorporated by reference to Part II, Item 8 of this annual report.

3. *Exhibits.* We have filed, or incorporated into this report by reference, the exhibits listed on the accompanying Index to Exhibits immediately following the signature page of this Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHUTTERFLY, INC.
(Registrant)

Dated: February 13, 2014

By: /s/ Brian M. Regan

Brian M. Regan
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Jeffrey T. Housenbold, Brian M. Regan and Brian R. Manca, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Annual Report on Form 10-K and to file same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and dates indicated.

Signature	Title	Date
/s/ Jeffrey T. Housenbold Jeffrey T. Housenbold	President, Chief Executive Officer and Director (Principal Executive Officer)	February 13, 2014
/s/ Brian M. Regan Brian M. Regan	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 13, 2014
/s/ Brian R. Manca Brian R. Manca	Vice President and Chief Accounting Officer (Principal Accounting Officer)	February 13, 2014
/s/ Philip A. Marineau Philip A. Marineau	Chairman of the Board of Directors and Director	February 13, 2014
/s/ Eric J. Keller Eric J. Keller	Director	February 13, 2014
/s/ Stephen J. Killeen Stephen J. Killeen	Director	February 13, 2014
/s/ Ann Mather Ann Mather	Director	February 13, 2014
/s/ Nancy J. Schoendorf Nancy J. Schoendorf	Director	February 13, 2014

/s/ Brian T. Swette Brian T. Swette	Director	February 13, 2014
/s/ James N. White James N. White	Director	February 13, 2014
/s/ Michael P. Zeisser Michael P. Zeisser	Director	February 13, 2014

INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference: Form	File No.	Date of First Filing	Exhibit Number	Provided Herewith
3.01	Restated Certificate of Incorporation.	S-1	333-135426	June 29, 2006	3.03	
3.02	Restated Bylaws.	10-Q	001-33031	July 31, 2012	3.02	
4.01	Form of common stock certificate.	S-1/A	333-135426	August 18, 2006	4.01	
4.02	Registration Rights Agreement, dated April 25, 2011, by and among Shutterfly, Inc. and the parties thereto.	8-K	001-33031	April 25, 2011	4.01	
4.03	Indenture, dates as of May 20, 2013, by and between Shutterfly, Inc. and Wells Fargo Bank, National Association, as trustee.	8-K	001-33031	May 20, 2013	4.01	
10.01	Form of Indemnity Agreement.*	S-1	333-135426	June 29, 2006	10.01	
10.02	1999 Stock Plan and forms of stock option agreement and a stock option exercise agreement.*	S-1	333-135426	June 29, 2006	10.02	
10.03	2006 Equity Incentive Plan, as amended.*	10-Q	001-33031	November 5, 2013	10.01	
10.04	Forms of stock option agreement, stock option exercise agreement, restricted stock agreement, restricted stock unit agreement, stock appreciation right agreement and stock bonus agreement under the 2006 Equity Incentive Plan, as amended.*	10-K	001-33031	February 7, 2011	10.24	
10.05	Form of Inducement Restricted Stock Unit Award Agreement.*	10-K	001-33031	February 14, 2013	10.04	
10.06	Shutterfly, Inc. 2013 Quarterly Bonus Plan.*	10-Q	001-33031	May 7 2013	10.01	
10.07	Shutterfly, Inc. Executive Stock Ownership Guidelines, as amended.*					X
10.08	Offer letter dated January 5, 2005 for Jeffrey T. Housenbold.*	S-1	333-135426	June 29, 2006	10.08	
10.09	Amendment to Employment Agreement dated December 8, 2008 for Jeffrey T. Housenbold.*	10-Q	001-33031	May 1, 2009	10.02	
10.10	Amendment Number 2 to Employment Agreement dated March 12, 2009 for Jeffrey T. Housenbold.*	10-Q	001-33031	May 1, 2009	10.03	
10.11	Offer Letter dated March 21, 2005 for Dan McCormick.*	10-Q	001-33031	May 3, 2010	10.03	
10.12	Amendment to Offer Letter dated December 26, 2008 for Dan McCormick.*	10-Q	001-33031	May 3, 2010	10.04	

Exhibit Number	Exhibit Description	Incorporated by Reference				Provided Herewith
		Form	File No.	Date of First Filing	Exhibit Number	
10.13	Offer letter dated January 17, 2007 for Dwayne Black.*	10-K	001-33031	March 20, 2007	10.15	
10.14	Amendment to Offer Letter dated December 23, 2008 for Dwayne Black.*	10-K	001-33031	February 24, 2009	10.2	
10.15	Offer Letter dated March 5, 2012 for John Boris.*	10-Q	001-33031	May 7, 2013	10.02	
10.16	Offer Letter dated December 17, 2007 for Peter Navin.*	10-Q	001-33031	May 3, 2010	10.05	
10.17	Amendment to Offer Letter dated December 26, 2008 for Peter Navin.*	10-Q	001-33031	May 3, 2010	10.06	
10.18	Offer Letter, dated July 18, 2012, by and between Shutterfly, Inc. and Brian Regan.*	8-K	001-33031	July 30, 2012	10.01	
10.19	Supply Agreement, dated as of April 20, 2007, by and between Shutterfly, Inc. and FUJIFILM U.S.A, Inc.**	10-Q	001-33031	August 1, 2007	10.18	
10.20	Amendment No. 2 to Fulfillment Agreement and Amendment No. 1 to Supply Agreement, dated as of March 29, 2010, by and between Shutterfly, Inc. and FUJIFILM North America Corporation.**	10-Q	001-33031	May 3, 2010	10.01	
10.21	Amendment No. 2 to Supply Agreement made as of August 23, 2012 by and between Shutterfly, Inc. and FUJIFILM North America Corporation.**	10-Q	001.33031	November 6, 2012	10.02	
10.22	Credit Agreement, dated as of November 22, 2011, by and among the Shutterfly, Inc., the Lenders (as defined therein) and JPMorgan Chase Bank, N.A.	10-K	001-33031	February 13, 2012	10.25	
10.23	Amendment No. 1 to Credit Agreement, dated as of May 10, 2013, by and among Shutterfly, Inc., the Lenders (as defined therein) and JPMorgan Chase Bank, N.A., as administrative agent.	8-K	001-33031	May 13, 2013	10.01	
10.24	Incremental Commitment Agreement dated as of December 6, 2013. by and among Shutterfly, Inc., the Incremental Lenders (as defined therein) and JPMorgan Chase Bank, N.A.					X

		Incorporated by Reference				
Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Provided Herewith
10.25	Letter Agreement, dated May 14, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.01	
10.26	Letter Agreement, dated May 14, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.02	
10.27	Letter Agreement, dated May 14, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.03	
10.28	Letter Agreement, dated May 14, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.04	
10.29	Letter Agreement, dated May 14, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.05	
10.30	Letter Agreement, dated May 14, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.06	
10.31	Letter Agreement, dated May 14, 2013, between Bank of America, N.A. and Shutterfly, Inc. regarding the Base Warrant Transaction.	8-K	001-33031	May 20, 2013	10.07	
10.32	Letter Agreement, dated May 14, 2013 between Bank of America, N.A. and Shutterfly, Inc. regarding the Base Call Option Transaction.	8-K	001-33031	May 20, 2013	10.08	
10.33	Letter Agreement, dated May 15, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.09	
10.34	Letter Agreement, dated May 15, 2013, between Morgan Stanley & Co. International plc and Shutterfly, Inc. regarding the Additional Call Option Transaction.	8-K	001-33031	May 20, 2013	10.10	

		Incorporated by Reference				
Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Provided Herewith
10.35	Letter Agreement, dated May 15, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.11	
10.36	Letter Agreement, dated May 15, 2013, between Credit Suisse International and Shutterfly, Inc. regarding the Additional Call Option Transaction.	8-K	001-33031	May 20, 2013	10.12	
10.37	Letter Agreement, dated May 15, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.13	
10.38	Letter Agreement, dated May 15, 2013, between Citibank, N.A. and Shutterfly, Inc. regarding the Additional Call Option Transaction.	8-K	001-33031	May 20, 2013	10.14	
10.39	Letter Agreement, dated May 15, 2013, between Bank of America, N.A. and Shutterfly, Inc. regarding the Additional Warrant Transaction.	8-K	001-33031	May 20, 2013	10.15	
10.40	Letter Agreement, dated May 15, 2013 between Bank of America, N.A. and Shutterfly, Inc. regarding the Additional Call Option Transaction.	8-K	001-33031	May 20, 2013	10.16	
23.01	Consent of Independent Registered Public Accounting Firm.					X
24.01	Power of Attorney. (See signature page of this Form 10-K)					X
31.01	Certification of Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
31.02	Certification of Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
32.01	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).***					X
32.02	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).***					X

		Incorporated by Reference				
Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Provided Herewith
101	The following financial statements from Shutterfly Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Stockholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements, tagged at Level I through IV.					X

* Represents a management contract or compensatory plan.

** Confidential treatment has been granted for certain portions of this document pursuant to an application for confidential treatment sent to the Securities and Exchange Commission. Such portions are omitted from this filing and were filed separately with the Securities and Exchange Commission.

*** This certification is not deemed "filed" for purposes of Section 18 of the Securities Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that Shutterfly specifically incorporates it by reference.

Exhibit 31.01

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

I, Jeffrey T. Housenbold, certify that:

1. I have reviewed this annual report on Form 10-K of Shutterfly, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 13, 2014

By: /s/ Jeffrey T. Housenbold

Jeffrey T. Housenbold
President and Chief Executive Officer
(Principal Executive and Financial Officer)

Exhibit 31.02

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

I, Brian M. Regan, certify that:

1. I have reviewed this annual report on Form 10-K of Shutterfly, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 13, 2014

By: /s/ Brian M. Regan

Brian M. Regan
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.01

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350

The undersigned, Jeffrey T. Housenbold, the President and Chief Executive Officer of Shutterfly, Inc. (the "Company"), pursuant to 18 U.S.C. §1350, hereby certifies that:

(i) the Annual Report on Form 10-K for the period ended December 31, 2013 of the Company (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 13, 2014

By: /s/ Jeffrey T. Housenbold

Jeffrey T. Housenbold
President and Chief Executive Officer
(Principal Executive and Financial Officer)

Exhibit 32.02

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350**

The undersigned, Brian M. Regan, Senior Vice President and Chief Financial Officer of Shutterfly, Inc. (the "Company"), pursuant to 18 U.S.C. §1350, hereby certifies that:

(i) the Annual Report on Form 10-K for the period ended December 31, 2013 of the Company (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 13, 2014

By: /s/ Brian M. Regan

Brian M. Regan
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Corporate and Stockholder Information

Board of Directors

Philip A. Marineau
Chairman of the Board and
Partner at LNK Partners

Jeffrey T. Housenbold
President, Chief Executive Officer
and Director, Shutterfly, Inc.

Eric J. Keller
Chief Operating Officer,
Kleiner Perkins Caufield & Byers

Stephen J. Killeen
Executive Chairman,
The CarbonNeutral Company

Ann Mather

Nancy J. Schoendorf
Managing Partner, Mohr, Davidow Ventures

Brian T. Swette
Non-Executive Chairman, Burger King

James N. White
Managing Director, Sutter Hill Ventures

Michael P. Zeisser
Private Investor

Executive Management Team

Jeffrey T. Housenbold
President, Chief Executive Officer
and Director

Brian M. Regan
Senior Vice President, Chief Financial Officer

Dwayne A. Black
Senior Vice President, Operations

John Boris
Senior Vice President, Chief Marketing Officer

Dan C. McCormick
Senior Vice President, Chief Operating Officer

Obtaining Financial Statements

A copy of our Annual Report on Form 10-K is posted to our website. You may also obtain a copy by written or email request to:

Investor Relations, Shutterfly, Inc.
2800 Bridge Parkway
Redwood City, California 94065
Email: IRinquiries@shutterfly.com

Annual Meeting

May 21, 2014 at 9:30 a.m. (PDT)
Hotel Sofitel, 223 Dolphin Drive,
Redwood City, CA 94065

Trading Information

The common stock of Shutterfly, Inc. is traded on the Nasdaq Stock Market (symbol: SFLY). If you wish to become a stockholder, please contact a stockbroker.

Transfer Agent

Information regarding stock certificates, change of address, ownership transfer or other stock matters can be obtained from:

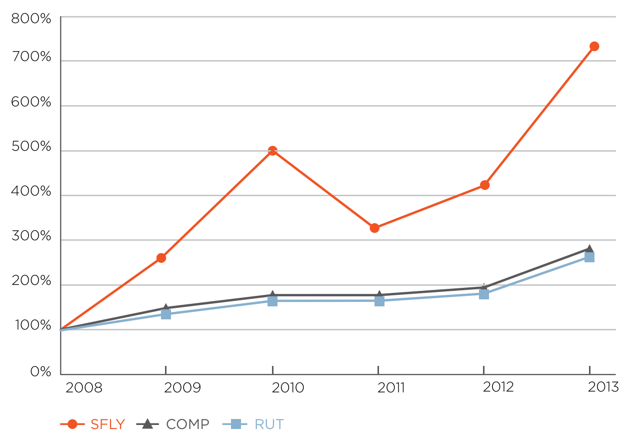
Computershare Trust Company, N.A.
250 Royall Street, Canton, MA 02021
877-905-1585
www.computershare.com/investor

Independent Public Accounting Firm

PricewaterhouseCoopers LLP

Performance Graph

The following graph compares the total cumulative stockholder return on the company's common stock with the total cumulative return on the Nasdaq Market Index and Russell 2000 Index on an annual basis for 2008 through 2013. An investment of $100 (with reinvestment of all dividends) is assumed to have been made in the company's common stock and in each of the indexes on December 31, 2008 and its relative performance is tracked through December 31, 2013. Our stock performance shown in the graph below is not indicative of future stock price performance.



The above graph and related information shall not be deemed “soliciting materials” or be deemed to be “filed” with the SEC, not shall such information be incorporated by reference into any future filing, except to the extent that we specifically incorporate it by reference into such filing.

Visit our web site at www.shutterflyinc.com

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