

Carbonite Inc
Form 10-K
March 10, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2014

OR

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

For the transition period from _____ to _____

Commission file number: 001-35264

CARBONITE, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation)

33-1111329
(I.R.S. Employer
Identification No.)

Two Avenue de Lafayette
Boston, Massachusetts
(Address of principal executive offices)
(617) 587-1100

02111
(Zip Code)

(Registrant's telephone number, including area code)
Securities Registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock, par value \$0.01 per share

Name of Exchange on Which Registered
The NASDAQ Stock Market LLC

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 Section 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 during

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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 Item 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer (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 30, 2014, the last business day of the registrant's most recently completed second quarter, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$247,403,250.

As of February 27, 2015, there were 27,249,579 shares of the registrant's common stock, par value \$0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2015 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K (the Annual Report), including the sections entitled “Business,” “Risk Factors,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” includes forward-looking statements. The words “believe,” “may,” “will,” “estimate,” “continue,” “anticipate,” “intend,” “expect,” “predict,” “potential,” expressions, as well as the negatives thereof, as they relate to us, our business, our management, and our industry, are intended to identify forward-looking statements. In light of risks and uncertainties discussed in this Annual Report, the forward-looking events and circumstances discussed in this Annual Report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events and financial trends affecting the financial condition of our business. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at or by which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made and/or management’s good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. These risks include, but are not limited to, those set forth under Item 1A of this Annual Report on Form 10-K.

Forward-looking statements speak only as of the date of this Annual Report. We may not actually achieve the plans, intentions, or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions, and expectations disclosed in the forward-looking statements we make. In addition, our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures, or investments that we may make.

You should read this Annual Report completely and with the understanding that our actual future results may be materially different from what we expect. We do not assume any obligation to update any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

ITEM 1. BUSINESS

Overview

Carbonite, Inc. (together with its subsidiaries, Carbonite, the Company, our, we, or us) provides cloud and hybrid backup solutions. Our solutions provide powerful features packaged in a cost-effective, simple, and secure manner, and are designed to address the specific needs of small and medium sized businesses (SMBs) and individuals. Carbonite was incorporated on February 10, 2005 and is a Delaware corporation. We founded Carbonite on one simple idea: all computers need to be backed up, and in this always connected and highly mobile world, cloud backup is the ideal approach. Our "set and forget" automated solution requires little effort and protects our customers' stored files even if their computers are lost, stolen, or destroyed. Today, our cloud and hybrid backup, recovery and archiving solutions help keep businesses in business.

As of December 31, 2014, we had subscribers in more than 100 countries, with subscribers based in the U.S. representing approximately 94% of our total revenue for each of 2014, 2013, and 2012.

We have developed a highly predictable subscription revenue model, with a consistently strong customer retention rate and a scalable infrastructure to support our growth. We generated revenue of \$122.6 million in 2014. We continue to invest in customer acquisition, and as a result we recorded a net loss of \$9.4 million in 2014. Our bookings have grown from \$54.1 million in 2010 to \$128.2 million in 2014. For a reconciliation of bookings to revenue for the last five years, see “Selected Consolidated Financial and Other Data.”

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Industry Trends

Several trends are fueling the growth of the business continuity and backup industries. International Data Corporation ("IDC"), predicts the amount of data users create and copy will increase exponentially from 4.4 zettabytes in 2013 to 44 zettabytes in 2020, and IT pros will deal with around 230GB of data per person¹. Another study indicated 22% of companies experienced data loss causing a "significant impact" to their business, and 70% of businesses with a significant data loss close their doors within a year². We predict that this rapid growth in data along with the need for data protection will continue to drive demand for business continuity solutions.

Your life - both business and personal - is digital. Computers have transformed the way people work, communicate, and lead their daily personal and professional lives. People store a plethora of information on computers and tablets, from financial records, correspondence, passwords, work files, and tax returns to music and photos. These files could be permanently destroyed due to equipment failure, theft, loss, viruses, and accidental deletions. This data is accumulated over time and is often irreplaceable, making loss devastating for the owner.

We expect that increasing interest in leveraging cloud infrastructure will drive increased spending on built-in-the-cloud solutions like ours. According to IDC, small businesses will spend \$589,673 million on IT in 2015³. The use of cloud-based business products will rise and adoption of Office 365 will double to 30 percent of all U.S. small businesses in 2015⁴.

Traditional alternatives to cloud backup such as, external hard disk drives, flash memory drives, CDs, DVDs, and tape backup drives, are limited by drive capacity, cumbersome to scale, prone to failure, not secure, and not accessible from a remote location. As a result, small businesses and individuals are increasingly searching for simple, affordable solutions that provide reliable and secure cloud backup and anytime, anywhere access to stored files. We believe that cloud and hybrid backup effectively address the limitations of traditional solutions and will be the predominant business continuity solution in the future.

¹EMC Digital Universe Study, with data and analysis by IDC, April 2014.

²Data Loss a Problem for Over One in Five Small Businesses,

<http://spanning.com/blog/data-loss-a-problem-for-over-one-in-five-small-businesses>.

³IDC, Market Analysis Perspective: SMB Markets: SMB v Enterprise Global Overview 2014 - attitudes, priorities, IT spending, Doc #252899, December 2014.

⁴IDC, Worldwide SMB Predictions, 2015, Doc #WC20141218, December 2014

Our Solution

We believe that our customers buy our backup, recovery and archiving solutions because they are powerful yet simple. We make it easy for customers to recover their files, and we provide anytime, anywhere access and high quality customer support.

We believe that our solutions provide the following benefits to all of our customers:

Power: Enterprise-grade solutions designed to meet the needs of small businesses and individuals.

Simplicity: Virtually effortless solutions that are easy to use and manage. Carbonite's products are "set and forget" and automatically protect data as it's created.

Security: Proven technology that protects what matters and provides peace of mind. We encrypt all customer files before they are transmitted to our data centers, guarding against unauthorized access to stored files and ensuring a high level of data security. In addition, we employ state-of-the-art data center security measures intended to prevent intrusions.

Value: We provide powerful products at an affordable price, and offer resources like a growing partner program and customer support for no additional charge.

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Our Key Competitive Strengths

We believe that our key competitive strengths include the following:

Brand awareness. We believe that we have among the highest brand awareness in the cloud backup market. We promote our brand through our multi-channel marketing program, which includes a broad presence in radio, online display advertising, television, print advertising, paid and natural search, and an affiliate and reseller network.

Scale. We believe that our large scale infrastructure, built over the last nine years, enables us to store additional files at lower incremental cost than our smaller competitors. In addition, we are able to purchase national advertising at advantageous rates, access advertising opportunities that may be unavailable to smaller businesses, and take advantage of sophisticated analytical marketing systems.

Optimized backup architecture. Our entire infrastructure is optimized for backup, which is a low transaction speed, high volume, write mostly application. We believe that our average storage costs per subscriber are lower than those realized by typical general purpose data center storage systems.

Comprehensive customer support. We believe that our customer support is more comprehensive than that offered by our primary competitors in the cloud backup market and aids in our customer retention. We provide telephone, live chat, and email customer support in our basic subscription fee.

Significant intellectual property portfolio. We have a significant intellectual property portfolio relating to our backup solutions. CARBONITE is a registered trademark in the U.S. and in over 30 other countries, including countries in the European Union.

Our Offerings

We intend to be a leading provider of business continuity solutions that keep businesses in business. Our suite of solutions include:

Carbonite Personal: For individuals, we offer annual plans that include unlimited cloud backup for one computer at three different service levels. All plans offer discounts for multi-year subscriptions.

Carbonite Pro: Our small business workstation solutions automatically back up files to the cloud and include an unlimited number of devices for an annual flat fee based on the amount of storage needed.

Carbonite Server Backup: Our hybrid server backup solution protects an unlimited number of servers, databases and live applications, and offers advanced management capabilities including scheduling, retention, bandwidth and compression settings, and detailed monitoring and reporting via a personalized server dashboard.

The following table sets forth key features of our Carbonite Personal Basic, Carbonite Personal Plus, and Carbonite Personal Prime consumer offerings:

	Carbonite Personal Basic	Carbonite Personal Plus	Carbonite Personal Prime
Coverage	One Computer	One computer plus one external hard drive for backup	One computer plus one external hard drive for backup
Supported operating systems	Windows and Mac	Windows	Windows
Pricing	\$59.99/year; unlimited storage	\$99.99/year; unlimited storage	\$149.99/year; unlimited storage
Subscription Period	Annual or multi-year	Annual or multi-year	Annual or multi-year
Customer support	U.S.-based telephone, live chat, and email	U.S.-based telephone, live chat, and email	U.S.-based telephone, live chat, and email
Sync & Share	Access, edit and share your	Access, edit and share your	

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Features	backed-up files from any of your devices (computer and select tablet and mobile devices)	backed-up files from any of your devices (computer and select tablet and mobile devices)	Access, edit and share your backed-up files from any of your devices (computer and select tablet and mobile devices)
	Automatic and continuous backup to the cloud, state-of-the-art security and file encryption, and recovery.	Automatic and continuous backup to the cloud, state-of-the-art security and file encryption, and recovery.	Automatic and continuous backup to the cloud, automatic video backup, courier recovery, state-of-the-art security and file encryption, and recovery.

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The following table sets forth key features of our Carbonite Pro Basic and Carbonite Pro Prime small business offerings:

	Carbonite Pro Basic	Carbonite Pro Prime
Coverage	Unlimited computers, external hard drives and NAS devices	Unlimited computers, external hard drives, NAS devices and Windows file servers
Supported operating systems	Windows and Mac	Windows and Windows Server
Pricing	\$269.99/year; 250 GB of backup storage space	\$599.99/year; 500 GB of backup storage space
Subscription Period	Annual or multi-year	Annual or multi-year
Customer support	U.S.-based telephone, live chat, and email	U.S.-based telephone, live chat, and email
Remote file access	Anytime, anywhere using a web browser	Anytime, anywhere using a web browser
Sync & Share	Access, edit and share your backed-up files from any of your devices (computer and select tablet and mobile devices)	Access, edit and share your backed-up files from any of your devices (computer and select tablet and mobile devices)
Features	Automatic and continuous backup to the cloud, state-of-the-art security and file encryption, recovery.	Automatic and continuous backup to the cloud, state-of-the-art security and file encryption, recovery.

The following table sets forth key features of our Carbonite Server Basic, Carbonite Server Prime, and Carbonite Server Pro Bundle solutions:

	Carbonite Server Basic	Carbonite Server Prime	Carbonite Server Pro Bundle
Coverage	Unlimited servers	Unlimited servers	Unlimited servers
Supported operating systems	Windows NTFS and ReFS file systems, Microsoft SQL Server, Microsoft Exchange Server, Microsoft SharePoint Server, Windows System State; MySQL Server, Oracle Server, Hyper-V	Windows NTFS and ReFS file systems, Microsoft SQL Server, Microsoft Exchange Server, Microsoft SharePoint Server, Windows System State; MySQL Server, Oracle Server, Hyper-V	All servers to the left, plus Windows XP, Windows Vista, Windows 7, Windows Server, Windows Small Business Server, Windows 8 and 8.1.
Pricing	\$799.99/year; 250 GB of cloud storage	\$899.99/year; 500 GB of cloud storage	\$999.99/year; 500 GB of cloud storage
Subscription Period	Annual or multi-year	Annual or multi-year	Annual or multi-year
Customer support	U.S.-based telephone, live chat, and email	U.S.-based telephone, live chat, and email	U.S.-based telephone, live chat, and email

We use sophisticated encryption technology to ensure the privacy of our customers' stored files. We encrypt files using a secure key before the files leave the customer's computer and transmit the encrypted files over the internet to one of our secure data centers. Customers' files remain encrypted on our servers to guard against unauthorized access. We employ outside security analysis firms, including anti-hacking specialists, to review and test our defenses and internal procedures.

Our Proprietary Server Software

At the core of our offerings is our proprietary server software designed specifically for cloud backup. The server software is comprised of two major components: the Carbonite Communications System (CCS) and the Carbonite File

System (CFS). CCS moves customer data between our software installed on our customers' computers and CFS running on our storage servers. CCS also balances loads across our server network. CFS manages the write-mostly database of stored files with the flexibility to operate on a wide variety of readily available third-party storage hardware.

We invest heavily in the development of our technologies. In 2014, 2013 and 2012, we spent \$24.1 million, \$20.9 million and \$19.9 million, respectively, on research and development. Our proprietary technologies are fundamental to our value proposition as they enable us to deliver the following benefits:

Scalability. We add storage capacity at the rate of approximately one petabyte every two weeks. CCS allows us to automatically balance processing and storage capacity across our large and expanding server network. CFS allows us to easily add storage capacity across multiple physical locations by automatically integrating new storage servers into our existing infrastructure.

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Reliability. We designed CCS and CFS to eliminate single points of failure. The modular design of these components uses well-defined protocols intended to ensure that customer stored files are accurate and free from errors. CFS provides proprietary disk error detection for errors that can occur over years of storage. Our software also incorporates checks and balances to verify data integrity.

Cost effectiveness. Storage cost is the biggest component of our cost of revenue. CCS enables us to dynamically load balance among servers to allow higher overall utilization. CFS enables us to reduce storage costs by utilizing almost every block of physical disk space to store customer files. We can choose the most cost-effective hardware solutions for our data centers because CFS allows us to operate in a heterogeneous hardware environment.

Marketing and Sales

Our marketing and sales efforts are focused on three primary goals: building brand awareness, acquiring customers at a low cost, and retaining existing customers. Our advertising reinforces our brand image by emphasizing ease of use, affordability, security, reliability, and anytime, anywhere access to stored files. We use radio advertising, online display advertising, television, print advertising, paid search, direct marketing, and affiliate and reseller marketing. Our public relations efforts include engaging the traditional press, new media, and social networks. Our distribution strategy is designed to sell large volumes of our solutions through our sales channel relationships including resellers. **Marketing.** Most of our revenue is from consumers who sign up for Carbonite backup on our website in response to our direct marketing campaigns. Our marketing efforts are designed to attract prospective customers, both consumer and small business, to our website and enroll them as paying customers, either through free trials or communication of the benefits of our solutions to the small business market.

Channel distribution. In order to further penetrate the extensive and diverse population of small businesses, we have and will continue to invest in our sales channel relationships. Our network of sales channel relationships includes distributors, resellers and retailers and is designed to sell large volumes of our relatively low-priced solutions to small business customers.

Retention. Our customer retention efforts are focused on establishing and maintaining long-term relationships with our customers by delivering a compelling customer experience and superior value, communicating regularly with customers through email, on-site messaging, and other media, and creating positive interactions with our customer support team. We monitor developing trends in subscription durations, renewals, and customer satisfaction to maximize our customer retention. We offer incentives to customers to purchase multi-year subscriptions, which we believe helps to increase our customer retention. As of December 31, 2014, 2013 and 2012, 25%, 28%, and 29%, respectively, of our customers had multi-year subscriptions.

Intellectual Property

We believe that the strength of our brand and the functionality of our software help differentiate us from our competitors. As such, our success depends upon our ability to protect our technologies and intellectual property, including our proprietary server software, which allows us to move and store vast amounts of customer data. To protect our intellectual property, we rely on a combination of trademark, patent, copyright, and trade secret laws, as well as confidentiality procedures and contractual restrictions. CARBONITE is a registered trademark in the U.S. and in over 30 other countries, including countries in the European Union. Carbonite also has additional registrations and/or pending applications for additional marks in the U.S. and/or other countries, including but not limited to "Carbonite The Better Backup Plan", "Back it up. Get it back", "Because Your Life is On Your Computer" Logo, "Carbonite" and the Green Dot Logo, Carbonite Lock Logo, Phanfare, Zmanda and the Z logo and Chinese character representations for Carbonite. In addition, we have eight issued patents, expiring at various times between 2027 and 2032, and 18 pending patent applications in the U.S. and internationally that cover both our technical infrastructure and our key usability and design concepts.

Competition

Our market is rapidly evolving due to technological advances that are driving changes in the way small and medium sized businesses operate. Over the past few years, competition has intensified, and we expect this to continue with the introduction of new technologies and market entrants. We compete against many companies across the storage, backup, archiving and cloud markets, ranging from those who provide a wide array of IT services, to those who provide only a specific business continuity product, to distributors and resellers.

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We believe key factors to successfully compete in the business continuity market include ease of installation and use, value, cloud storage, data security, reliability, and brand reputation. We believe that Carbonite competes favorably with respect to each of the key factors by providing powerful, yet simple cloud and hybrid business continuity solutions. Our offerings are easy-to-use, affordable, secure, include a variety of storage capacity options, and enable anytime, anywhere access to files.

Historically, we have competed with CrashPlan (Code 42) and Mozy (EMC) for workstation backup, and with offerings from Symantec, Acronis and Datto for Server and Appliance offerings. We expect many of our competitors and their positions to change, as we complete our pivot to serve the SMB market and as the markets we compete in continue to evolve.

Employees

As of December 31, 2014, we had 579 full-time and 10 part-time employees. Of our full-time employees, 306 were in operations and support, 89 were in sales and marketing, 107 were in research and development, and 77 were in general and administrative functions. None of our employees are covered by collective bargaining agreements.

Subsequent Events

On December 24, 2014, Copper Holdings, Inc., a wholly owned subsidiary of j2 Global, Inc. (“j2”), commenced an unsolicited tender offer to acquire all of the outstanding shares of our common stock. The tender offer was subsequently withdrawn. On January 8, 2015, our Board of Directors adopted a Rights Agreement, pursuant to which “rights” are issued to all Company common shareholders that, if activated upon an attempted unfriendly acquisition, would deter and thereby minimize the risk of, any potential hostile takeovers. We have also received notices of director nominations from Engine Capital, L.P. (“Engine Capital”) and j2.

Available Information

We file reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and other filings required by the SEC. We make available on our website (www.carbonite.com) our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. These materials are available free of charge on or through our website via the Investor Relations page at www.carbonite.com. References to our website address in this report are intended to be inactive textual references only, and none of the information contained on our website is part of this Annual Report or incorporated in this Annual Report by reference.

The public may read and copy any materials that we file with the SEC at the SEC’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 SEC at 1-800-SEC-0330. The SEC maintains an internet site (<http://www.sec.gov>) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

ITEM 1A.

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information in this Annual Report on Form 10-K before making an investment decision. Our business, prospects, financial condition, or operating results could be harmed by any of these risks, as well as other risks not currently known to us or that we currently consider immaterial. The trading price of our common stock could decline due to any of these risks, and, as a result, you may lose all or part of your investment.

Risks Related to Our Business

We have experienced periods of losses and negative cash flow since our inception, and we may not be able to sustain profitability or positive cash flow in the future.

We experienced net losses of \$18.9 million for 2012, \$10.6 million for 2013, and \$9.4 million for 2014, and we have an accumulated deficit of approximately \$139.3 million as of December 31, 2014. While we have experienced revenue growth over these same periods, we may not be able to achieve profitability in the future or on a consistent basis. We expect to continue making significant expenditures to develop and expand our business, including for advertising, customer acquisition, technology infrastructure, storage capacity, product development, and international

expansion, in an effort to increase and

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service our customer base. We also expect that our results may fluctuate due to a variety of factors described elsewhere in this Annual Report, including the timing and amount of our advertising expenditures, which are seasonal, the timing and amount of expenditures related to the development of technologies and solutions, and to defend intellectual property infringement and other claims. We may also incur increased losses and negative cash flow in the future for a variety of reasons, and we may encounter unforeseen expenses, difficulties, complications, delays, and other unknown events.

Any significant disruption in our service or loss or misuse of our customers' data could damage our reputation and harm our business and operating results.

Our brand, reputation, and ability to attract, retain, and serve our customers are dependent upon the reliable performance of our service and our customers' ability to readily access their stored files. Our customers rely on our cloud backup solution to store digital copies of their valuable data files, including financial records, business information, photos, and other personally meaningful content. Our data centers, and our third party data center providers, are vulnerable to damage or interruption from human error, intentional bad acts, computer viruses or hackers, earthquakes, hurricanes, floods, fires, war, terrorist attacks, power losses, hardware failures, systems failures, telecommunications failures, and similar events, any of which could limit our customers' ability to access their files and could prevent us from being able to continuously back up our customers' files. Prolonged delays or unforeseen difficulties in connection with adding storage capacity or upgrading our network architecture when required may cause our service quality to suffer. A breach of our network security and systems could also cause the loss or public disclosure of, or access by third parties to, our customers' stored files. Any event that significantly disrupts our service or exposes our customers' stored files to misuse could damage our reputation and harm our business and operating results, including reducing our revenue, causing us to issue credits to customers, subjecting us to potential liability, harming our renewal rates, or increasing our cost of acquiring new customers.

The market for cloud solutions is competitive, and if we do not compete effectively, our operating results could be harmed.

We compete with cloud backup providers and providers of traditional hardware-based backup systems. Many of our actual and potential competitors benefit from competitive advantages over us, such as greater name recognition, longer operating histories, more varied services, and larger marketing budgets, as well as greater financial, technical, and other resources. In addition, many of our competitors have established marketing relationships and major distribution agreements with computer manufacturers, internet service providers, and resellers, giving them access to larger customer bases. Some of our competitors may make acquisitions or enter into strategic relationships to offer a more comprehensive service than we do. These combinations may make it more difficult for us to compete effectively. We expect these trends to continue as competitors attempt to strengthen or maintain their market positions.

Demand for our cloud and hybrid backup solutions is sensitive to price. Many factors, including our advertising, customer acquisition and technology costs, and our current and future competitors' pricing and marketing strategies, can significantly affect our pricing strategies. Certain of our competitors offer, or may in the future offer, lower-priced or free products or services that compete with our solutions. Similarly, certain competitors may use internet-based marketing strategies that enable them to acquire customers at a lower cost than us. There can be no assurance that we will not be forced to engage in price-cutting initiatives, or to increase our advertising and other expenses to attract and retain customers in response to competitive pressures, either of which could have a material adverse effect on our revenue and operating results.

Over the long term, we intend to invest in research and development activities, and these investments may achieve delayed, or lower than expected, benefits which could harm our operating results.

While we intend to focus on managing our costs and expenses, over the long term, we also intend to invest in research and development activities as we focus on organic growth through internal innovation. We are likely to recognize the costs associated with these investments earlier than some of the anticipated benefits, and the return on these investments may be lower, or may develop more slowly, than we expect. If we do not achieve the benefits anticipated from these investments, or if the achievement of these benefits is delayed, our operating results may be adversely affected.

We have in the past incurred, and will continue to incur, significant research and development expenses as we strive to remain competitive. New product development and introduction involves a significant commitment of time and resources and is subject to a number of risks and challenges including:

- the difficulty in forecasting customer preferences or demand accurately;
- the inability to expand product capacity to meet demand for new products;

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the inability to successfully manage the transition from older products;

the impact of customers' demand for new products on the products being replaced, thereby causing a decline in sales of existing products and an excessive, obsolete supply of inventory;

delays in initial shipments of new products;

adapting to emerging and evolving industry standards and to technological developments by our competitors and customers;

entering into new or unproven markets with which we have limited experience

the response of competitors to the introductions of new products; and

the desire by customers to evaluate new products for extended periods of time.

Our failure to introduce new or enhanced products on a timely basis, keep pace with rapid industry, technological or market changes or effectively manage the transitions to new products or new technologies could have a material adverse effect on our business, results of operations or financial condition.

We may not be able to respond to rapid technological changes with new solutions, which could have a material adverse effect on our operating results.

The cloud and hybrid business continuity market is characterized by rapid technological change and frequent new product and service introductions. Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing solutions, introduce new features and products, and sell into new markets. We are in the process of addressing the challenges of dynamic and accelerating market trends, such as the decline in the PC market, the market shift towards tablets within mobility and architectural shifts in the provision of security and storage solutions, all of which has made it more difficult for us to compete effectively and requires us to improve our product and service offerings. Customers may require features and capabilities that our current solutions do not have. Our failure to develop solutions that satisfy customer preferences in a timely and cost-effective manner may harm our ability to renew our subscriptions with existing customers and to create or increase demand for our solutions, and may adversely impact our operating results.

The introduction of new services by competitors or the development of entirely new technologies to replace existing offerings could make our solutions obsolete or adversely affect our business and operating results. In addition, any new markets or countries into which we attempt to sell our solutions may not be receptive. We may experience difficulties with software development, design, or marketing that could delay or prevent our development, introduction, or implementation of new solutions and enhancements. We have in the past experienced delays in the planned release dates of new features and upgrades, and have discovered defects in new solutions after their introduction. There can be no assurance that new solutions or upgrades will be released according to schedule, or that when released they will not contain defects. Either of these situations could result in adverse publicity, loss of revenue, delay in market acceptance, or claims by customers brought against us, all of which could have a material adverse effect on our reputation, business, operating results, and financial condition. Moreover, upgrades and enhancements to our solutions may require substantial investment and we have no assurance that such investments will be successful. If customers do not widely adopt enhancements to our solutions, we may not be able to realize a return on our investment. If we are unable to develop, license, or acquire enhancements to our existing solutions on a timely and cost-effective basis, or if such enhancements do not achieve market acceptance, our business, operating results, and financial condition may be adversely affected.

Our limited operating history makes it difficult to evaluate our current business and future prospects, and, because we recognize revenue from subscriptions over the term of the relevant subscription period, downturns or upturns in subscription sales are not reflected immediately in our operating results.

We have been in existence since 2005, and our revenue has grown rapidly from \$38.6 million in 2010 to \$122.6 million in 2014, representing a compound annual growth rate of 34% over that period. We do not expect that this growth rate will continue in future periods and you should not rely on the revenue growth of any prior quarterly or annual periods as an indication of our future performance. In addition, because we recognize revenue from customers over the terms of their subscriptions, a large portion of our revenue for each quarter reflects deferred revenue from subscriptions entered into during previous quarters, and downturns or upturns in subscription sales or renewals may not be reflected in our operating results until

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later periods. We may not achieve sufficient revenue to achieve or maintain positive cash flow from operations or profitability, and our limited operating history may make it difficult for you to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries, including increasing expenses as we continue to grow our business. If we do not manage these risks successfully, our business will be harmed. If our future growth fails to meet investor or analyst expectations, it could have a negative effect on our stock price. If our growth rate were to decline significantly or become negative, it could adversely affect our financial condition and operating results.

A decline in demand for our solutions or for cloud solutions in general could cause our revenue to decline.

We derive, and expect to continue to derive, substantially all of our revenue from the sale of our cloud and hybrid backup solutions, a rapidly changing market. Changes in customer preferences for cloud solutions may have a disproportionately greater impact on us than if we offered multiple products and services. The market for cloud solutions is subject to rapidly changing customer demand and trends in preferences. Some of the potential factors that could affect interest in and demand for cloud solutions include:

- awareness of our brand and the cloud and hybrid backup solutions category generally;
- the appeal and reliability of our solutions;
- the price, performance, features, and availability of products and services that compete with ours;
- public concern regarding privacy and data security;
- our ability to maintain high levels of customer satisfaction; and
- the rate of growth in online solutions generally.

In addition, substantially all of our revenue is currently derived from customers in the U.S. Consequently, a decrease of interest in and demand for cloud backup solutions in the U.S. could have a disproportionately greater impact on us than if our geographic mix of revenue was less concentrated.

If we are unable to attract new customers to our solutions on a cost-effective basis, our revenue and operating results would be adversely affected.

We generate substantially all of our revenue from the sale of subscriptions to our solutions. In order to grow, we must continue to attract a large number of customers on a cost-effective basis, many of whom have not previously used cloud backup solutions. We use and periodically adjust a diverse mix of advertising and marketing programs to promote our solutions. Significant increases in the pricing of one or more of our advertising channels would increase our advertising costs or cause us to choose less expensive and perhaps less effective channels. As we add to or change the mix of our advertising and marketing strategies, we intend to expand into channels with significantly higher costs than our current programs, which could adversely affect our operating results. We may incur advertising and marketing expenses significantly in advance of the time we anticipate recognizing any revenue generated by such expenses, and we may only at a later date, or never, experience an increase in revenue or brand awareness as a result of such expenditures. We have made in the past, and may make in the future, significant investments to test new advertising, and there can be no assurance that any such investments will lead to the cost-effective acquisition of additional customers. If we are unable to maintain effective advertising programs, our ability to attract new customers could be adversely affected, our advertising and marketing expenses could increase substantially, and our operating results may suffer.

A portion of our potential customers locate our website through search engines, such as Google, Bing, and Yahoo!. Our ability to maintain the number of visitors directed to our website is not entirely within our control. If search engine companies modify their search algorithms in a manner that reduces the prominence of our listing, or if our competitors' search engine optimization efforts are more successful than ours, fewer potential customers may click through to our website. In addition, the cost of purchased listings has increased in the past and may increase in the future. A decrease in website traffic or an increase in search costs could adversely affect our customer acquisition efforts and our operating results.

A significant portion of our customers first try our cloud backup solutions through free trials. We seek to convert these free trial users to paying customers of our solutions. If our rate of conversion suffers for any reason, our revenue may decline and our business may suffer.

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If we are unable to retain our existing customers, our revenue and operating results would be adversely affected. If our efforts to satisfy our existing customers are not successful, we may not be able to retain them, and as a result, our revenue and ability to grow would be adversely affected. We may not be able to accurately predict future trends in customer renewals. Customers choose not to renew their subscriptions for many reasons, including if customer service issues are not satisfactorily resolved, a desire to reduce discretionary spending, or a perception that they do not use the service sufficiently, that the solution is a poor value, or that competitive services provide a better value or experience. If our customer retention rate decreases, we may need to increase the rate at which we add new customers in order to maintain and grow our revenue, which may require us to incur significantly higher advertising and marketing expenses than we currently anticipate, or our revenue may decline. A significant decrease in our customer retention rate would therefore have an adverse effect on our business, financial condition, and operating results.

Our relationships with our partners and distributors may be terminated or may not continue to be beneficial in generating new customers, which could adversely affect our ability to increase our customer base.

We maintain a network of active partners and distributors, which refer customers to us through links on their websites and outbound promotion to their customers. If we are unable to maintain our contractual relationships with existing partners and distributors, or establish new contractual relationships with potential partners and distributors, we may experience delays and increased costs in adding customers, which could have a material adverse effect on us. The number of customers that we are able to add through these relationships is dependent on the marketing efforts of our partners and distributors, over which we have very little control.

If we are unable to expand our base of small business customers, our business could be adversely affected.

In 2010, we introduced the first version of our backup solution targeted at small businesses. We have committed and continue to commit substantial resources to the expansion and increased marketing of our small business solutions. If we are unable to market and sell our solutions to small businesses with competitive pricing and in a cost-effective manner, our ability to grow our revenue and achieve profitability will be harmed. We believe that it is more difficult and expensive to attract and retain small business customers than individuals, because small businesses:

- are difficult to reach without using more expensive, targeted sales campaigns;

- may have different or much more complex needs than those of individual consumers, such as archiving, version control, enhanced security requirements, and other forms of encryption and authentication, which our solutions may not adequately address; and

- frequently cease operations due to the sale or failure of their business.

In addition, small businesses frequently have limited budgets and are more likely to be significantly affected by economic downturns than larger, more established companies. As a result, they may choose to spend funds on items other than our solutions, particularly during difficult economic times. If we are unsuccessful in meeting the needs of potential small business customers, it could adversely affect our future growth and operating results.

If we are unable to sustain market recognition of and loyalty to our brand, or if our reputation were to be harmed, we could lose customers or fail to increase the number of our customers, which could harm our revenue, operating results, and financial condition.

Given our small business and consumer market focus, maintaining and enhancing the Carbonite brand is critical to our success. We believe that the importance of brand recognition and loyalty will increase in light of increasing competition in our markets. We plan to continue investing substantial resources to promote our brand, both domestically and internationally, but there is no guarantee that our brand development strategies will enhance the recognition of our brand. Some of our existing and potential competitors have well-established brands with greater recognition than we have. If our efforts to promote and maintain our brand are not successful, our operating results and our ability to attract and retain customers may be adversely affected. In addition, even if our brand recognition and loyalty increases, this may not result in increased use of our solutions or higher revenue.

Our solutions, as well as those of our competitors, are regularly reviewed in computer and business publications. Negative reviews, or reviews in which our competitors' products and services are rated more highly than our solutions, could negatively affect our brand and reputation. From time-to-time, our customers express dissatisfaction with our solutions, including, among

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other things, dissatisfaction with our customer support, our billing policies, and the way our solutions operate. If we do not handle customer complaints effectively, our brand and reputation may suffer, we may lose our customers' confidence, and they may choose not to renew their subscriptions. In addition, many of our customers participate in online blogs about computers and internet services, including our solutions, and our success depends in part on our ability to generate positive customer feedback through such online channels where consumers seek and share information. If actions that we take or changes that we make to our solutions upset these customers, their blogging could negatively affect our brand and reputation. Complaints or negative publicity about our solutions or billing practices could adversely impact our ability to attract and retain customers and our business, financial condition, and operating results.

The termination of our relationship with any major credit card company would have a severe, negative impact on our ability to collect revenue from customers. Increases in credit card processing fees would increase our operating expenses and adversely affect our operating results.

Substantially all of our customers purchase our solutions online with credit cards, and our business depends upon our ability to offer credit card payment options. The termination of our ability to process payments on any major credit card would significantly impair our ability to operate our business and significantly increase our administrative costs related to customer payment processing. If we fail to maintain our compliance with the data protection and documentation standards adopted by the major credit card issuers and applicable to us, these issuers could terminate their agreements with us, and we could lose our ability to offer our customers a credit card payment option. If these issuers increase their credit card processing fees because we experience excessive chargebacks or refunds or for other reasons, it could adversely affect our business and operating results.

Any significant disruption in service on our websites, in our computer systems, or caused by our third party storage and system providers could damage our reputation and result in a loss of customers, which would harm our business, financial condition, and operating results.

Our brand, reputation, and ability to attract, retain and serve our customers are dependent upon the reliable performance of our websites, network infrastructure and payment systems, and our customers' ability to readily access their stored files. We have experienced interruptions in these systems in the past, including server failures that temporarily slowed down our websites' performance and our customers' ability to access their stored files, or made our websites and infrastructure inaccessible, and we may experience interruptions in the future. Our data center leases expire at various times in 2015, 2016, and 2018 with rights of extension. If we are unable to renew these agreements on commercially reasonable terms, we may be required to transfer that portion of our computing and storage capacity to new data center facilities, and we may incur significant costs and possible service interruption in connection with doing so. In addition, while we operate and maintain the primary elements of our websites and network infrastructure, some elements of this complex system are operated by third parties that we do not control and that would require significant time to replace. We expect this dependence on third parties to increase. In particular, we utilize Amazon Web Services and Google Cloud Storage to provide us with some computing and storage capacity pursuant to agreements that continue until terminated upon written notice by either party. All of these third-party systems are located in data center facilities operated by third parties. Interruptions in our systems, the third-party systems on which we rely, or the use of our data facilities, whether due to system failures, computer viruses, physical or electronic break-ins, damage or interruption from human error, power losses, hardware failures, systems failures, telecommunications failures or other factors, could affect the security or availability of our websites and infrastructure, prevent us from being able to continuously back up our customers' data or our customers from accessing their stored data, and may damage our customers' stored files. Any financial difficulties, such as bankruptcy, faced by our third-party data center operators or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict. Moreover, if our third-party data center providers are unable to keep up with our growing needs for capacity, this could have an adverse effect on our business. Interruptions in our services might reduce our revenue, cause us to issue credits or refunds to customers, subject us to potential liability, or harm our renewal rates.

In addition, prolonged delays or unforeseen difficulties in connection with adding storage capacity or upgrading our network architecture when required may cause our service quality to suffer. Problems with the reliability or security of

our systems could harm our reputation. Damage to our reputation and the cost of remedying these problems could negatively affect our business, financial condition, and operating results.

Our systems provide redundancy at the disk level, but do not keep separate, redundant copies of stored customer files. Instead, we rely on the fact that our customers, in effect, back up our system by maintaining the primary instance of their files. We do not intend to create redundant backup sites for our solutions. As such, a total failure of our systems, or the failure of any of our systems, could result in the loss of or a temporary inability to back up our customers' data and result in our customers being unable to access their stored files. If one of our data centers fails at the same time that our customers' computers fail, we

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would be unable to provide stored copies of their data. If this were to occur, our reputation could be compromised and we could be subject to liability to the customers that were affected.

Our success depends on our customers' continued high-speed access to the internet and the continued reliability of the internet infrastructure.

Our business depends on our customers' high-speed access to the internet, as well as the continued maintenance and development of the internet infrastructure. The future delivery of our solutions will depend on third-party internet service providers to expand high-speed internet access, to maintain a reliable network with the necessary speed, data capacity and security, and to develop complementary products and services, including high-speed modems, for providing reliable and timely internet access and services. All of these factors are out of our control. To the extent that the internet continues to experience an increased number of users, frequency of use, or bandwidth requirements, the internet may become congested and be unable to support the demands placed on it, and its performance or reliability may decline. Any internet outages or delays could adversely affect our ability to provide services to our customers. If the security of our customers' confidential information stored in our systems is breached or their stored files are otherwise subjected to unauthorized access, our reputation and business may be harmed, and we may be exposed to liability.

Our customers rely on our solutions to store digital copies of their files, including financial records, business information, photos, and other personally meaningful content. We also store credit card information and other personal information about our customers. A breach of our network security and systems or other events that cause the loss or public disclosure of, or access by third parties to, our customers' stored files could have serious negative consequences for our business, including possible fines, penalties and damages, reduced demand for our solutions, an unwillingness of customers to provide us with their credit card or payment information, an unwillingness of our customers to use our solutions, harm to our reputation and brand, loss of our ability to accept and process customer credit card orders, and time-consuming and expensive litigation. Third parties may be able to circumvent our security by deploying viruses, worms, and other malicious software programs that are designed to attack or attempt to infiltrate our systems and networks and we may not immediately discover these attacks or attempted infiltrations. Further, outside parties may attempt to fraudulently induce our employees, consultants, or affiliates to disclose sensitive information in order to gain access to our information or our customers' information. The techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently, often are not recognized until launched against a target, and may originate from less regulated or remote areas around the world. As a result, we may be unable to proactively address these techniques or to implement adequate preventative or reactionary measures. In addition, employee or consultant error, malfeasance, or other errors in the storage, use, or transmission of personal information could result in a breach of customer or employee privacy. We maintain insurance coverage to mitigate the potential financial impact of these risks; however, our insurance may not cover all such events or may be insufficient to compensate us for the potentially significant losses, including the potential damage to the future growth of our business, that may result from the breach of customer or employee privacy.

Many states have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, which may cause our customers to lose confidence in the effectiveness of our data security measures. Any security breach, whether successful or not, would harm our reputation and could cause the loss of customers. Similarly, if a well-publicized breach of data security at any other cloud backup service provider or other major consumer website were to occur, there could be a general public loss of confidence in the use of the internet for cloud backup services or commercial transactions generally. Any of these events could have material adverse effects on our business, financial condition, and operating results.

Our products are complex and operate in a wide variety of environments, systems, applications and configurations, which could result in errors or product failures.

Because we offer very complex products, undetected errors, failures, or bugs may occur, especially when products are first introduced or when new versions are released. Our products are often installed and used in large-scale computing environments with different operating systems, system management software, and equipment and networking configurations, which may cause errors or failures in our products or may expose undetected errors, failures, or bugs

in our products. Our customers' computing environments are often characterized by a wide variety of standard and non-standard configurations that make pre-release testing for programming or compatibility errors very difficult and time-consuming. In addition, despite testing by us and others, errors, failures, or bugs may not be found in new products or releases until after commencement of commercial shipments. In the past, we have discovered software errors, failures, and bugs in certain of our product offerings after their introduction and, in some cases, have experienced delayed or lost revenues as a result of these errors.

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Errors, failures, or bugs in products released by us could result in negative publicity, damage to our brand, product returns, loss of or delay in market acceptance of our products, loss of competitive position, or claims by customers or others. Many of our end-user customers use our products in applications that are critical to their businesses and may have a greater sensitivity to defects in our products than to defects in other, less critical, software products. In addition, if an actual or perceived breach of information integrity or availability occurs in one of our end-user customer's systems, regardless of whether the breach is attributable to our products, the market perception of the effectiveness of our products could be harmed. Alleviating any of these problems could require significant expenditures of our capital and other resources and could cause interruptions, delays, or cessation of our product licensing, which could cause us to lose existing or potential customers and could adversely affect our operating results.

We process, store and use personal information and other data, which subjects us to governmental regulation and other legal obligations related to privacy, and our actual or perceived failure to comply with such obligations could harm our business.

We receive, store, and process personal information and other customer data. There are numerous federal, state, local, and foreign laws regarding privacy and the storing, sharing, use, processing, disclosure and protection of personal information and other customer data, the scope of which are changing, subject to differing interpretations, and may be inconsistent among countries or conflict with other rules. We generally seek to comply with industry standards and are subject to the terms of our privacy policies and privacy-related obligations to third parties. We strive to comply with all applicable laws, policies, legal obligations, and industry codes of conduct relating to privacy and data protection to the extent possible. However, it is possible that these obligations may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other rules or our practices. Any failure or perceived failure by us to comply with our privacy policies, our privacy-related obligations to customers or other third parties, our privacy-related legal obligations, or any compromise of security that results in the unauthorized release or transfer of personally identifiable information or other customer data, may result in governmental enforcement actions, litigation, or public statements against us by consumer advocacy groups or others and could cause our customers to lose trust in us, which could have an adverse effect on our reputation and business. Our customers may also accidentally disclose their passwords or store them on a mobile device that is lost or stolen, creating the perception that our systems are not secure against third-party access. Additionally, if third parties that we work with, such as vendors or developers, violate applicable laws or our policies, such violations may also put our customers' information at risk and could in turn have an adverse effect on our business. Any significant change to applicable laws, regulations, or industry practices regarding the use or disclosure of our customers' data, or regarding the manner in which the express or implied consent of customers for the use and disclosure of such data is obtained, could require us to modify our solutions and features, possibly in a material manner, and may limit our ability to develop new services and features that make use of the data that our customers voluntarily share with us.

Our solutions are used by customers in the health care industry and we must comply with numerous federal and state laws related to patient privacy in connection with providing our solutions to these customers.

Our solutions are used by customers in the health care industry and we must comply with numerous federal and state laws related to patient privacy in connection with providing our solutions to these customers. In particular, the Health Insurance Portability and Accountability Act of 1996, or HIPAA, and the Health Information Technology for Economic and Clinical Health Act, or HITECH, include privacy standards that protect individual privacy by limiting the uses and disclosures of individually identifiable health information and implementing data security standards.

Because our solutions may backup individually identifiable health information for our customers, our customers are mandated by HIPAA to enter into written agreements with us-known as business associate agreements-that require us to safeguard individually identifiable health information. Business associate agreements typically include:

- a description of our permitted uses of individually identifiable health information;
- a covenant not to disclose that information except as permitted under the agreement and to make our subcontractors, if any, subject to the same restrictions;
- assurances that appropriate administrative, physical, and technical safeguards are in place to prevent misuse of that information;

an obligation to report to our customers any use or disclosure of that information other than as provided for in the agreement;

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a prohibition against our use or disclosure of that information if a similar use or disclosure by our customers would violate the HIPAA standards;

the ability of our customers to terminate their subscription to our solution if we breach a material term of the business associate agreement and are unable to cure the breach;

the requirement to return or destroy all individually identifiable health information at the end of the customer's subscription; and

access by the Department of Health and Human Services to our internal practices, books, and records to validate that we are safeguarding individually identifiable health information.

We may not be able to adequately address the business risks created by HIPAA or HITECH implementation or comply with our obligations under our business associate agreements. Furthermore, we are unable to predict what changes to HIPAA, HITECH or other laws or regulations might be made in the future or how those changes could affect our business or the costs of compliance. Failure by us to comply with any of the federal and state standards regarding patient privacy may subject us to penalties, including civil monetary penalties and, in some circumstances, criminal penalties, which could have an adverse effect on our business, financial condition, and operating results. Our operating results have fluctuated in the past and may continue to do so in the future. As a result, we may fail to meet or exceed the expectations of securities analysts or investors, which could cause our stock price to decline. Our quarterly and annual operating results may fluctuate as a result of a variety of factors, many of which are outside of our control. If our quarterly or annual operating results or guidance fall below the expectations of securities analysts or investors, the price of our common stock could decline substantially. The following factors, among others, could cause fluctuations in our quarterly or annual operating results or guidance:

- our ability to attract new customers and retain existing customers;
- our ability to accurately forecast revenue and appropriately plan our expenses;
- our ability to introduce new solutions;
- the actions of our competitors, including pricing changes or the introduction of new products;
- our ability to effectively manage our growth;
- the mix of annual and multi-year subscriptions at any given time;
- seasonal variations or other cyclicalities in the demand for our solutions, including the purchasing and budgeting cycles of our small business customers;
- the timing and cost of advertising and marketing efforts;
- the timing and cost of developing or acquiring technologies, services, or businesses;
- the timing, operating cost, and capital expenditures related to the operation, maintenance, and expansion of our business;
- service outages or security breaches and any related impact on our reputation;
- our ability to successfully manage any future acquisitions of businesses, solutions, or technologies;
- the impact of worldwide economic, industry, and market conditions and those conditions specific to internet usage and online businesses;
- costs associated with defending intellectual property infringement and other claims; and
- changes in government regulation affecting our business.

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We believe that our quarterly and annual revenue and operating results may vary significantly in the future and that period-to-period comparisons of our operating results may not be meaningful. You should not rely on the results of one period as an indication of future performance.

Seasonal variations in our business may also cause fluctuations in our financial results. For example, we generally spend more on advertising during the first and third quarters of each year to capitalize on lower advertising rates in these periods and increased sales of devices that create or store data during post-holiday and back to school periods and our bookings tend to be higher in these periods. While we believe that these seasonal trends have affected and will continue to affect our quarterly and annual results, our trajectory of rapid growth may have overshadowed these effects to date. We believe that our business may become more seasonal in the future as our growth rate slows, and that such seasonal variations in advertising expenditures and customer purchasing patterns may result in fluctuations in our financial results.

Growth may place significant demands on our management and our infrastructure.

We have experienced substantial growth in our business. This growth has placed and may continue to place significant demands on our management and our operational and financial infrastructure. As our operations grow in size, scope, and complexity, we will need to improve and upgrade our systems and infrastructure to attract, service, and retain an increasing number of customers. The expansion of our systems and infrastructure will require us to commit substantial financial, operational, and technical resources in advance of an increase in the volume of business, with no assurance that the volume of business will increase. Any such additional capital investments will increase our cost base.

Continued growth could also strain our ability to maintain reliable service levels for our customers, develop and improve our operational, financial, and management controls, enhance our reporting systems and procedures, and recruit, train, and retain highly skilled personnel. If we fail to achieve the necessary level of efficiency in our organization as we grow, our business, financial condition, and operating results could be harmed.

We may expand by continuing to acquire or invest in other companies, which may divert our management's attention, result in additional dilution to our stockholders, and consume resources that are necessary to sustain our business.

We may in the future continue to acquire complementary products, services, technologies, or businesses. We may also enter into relationships with other businesses to expand our portfolio of solutions or our ability to provide our solutions in foreign jurisdictions, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing, or investments in other companies. We do not have substantial experience with integrating and managing acquired businesses or assets. Negotiating these transactions can be time-consuming, difficult and expensive, and our ability to complete these transactions may often be subject to conditions or approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close.

Acquisitions may also disrupt our business, divert our resources, and require significant management attention that would otherwise be available for the development of our business. Moreover, the anticipated benefits of any acquisition, investment, or business relationship may not be realized or we may be exposed to unknown liabilities, including litigation against the companies that we may acquire. In connection with any such transaction, we may:

- issue additional equity securities that would dilute our stockholders;
- use cash that we may need in the future to operate our business;
- incur debt on terms unfavorable to us, that we are unable to repay, or that may place burdensome restrictions on our operations;
- incur large charges or substantial liabilities; or
- become subject to adverse tax consequences or substantial depreciation, deferred compensation, or other acquisition-related accounting charges.

Any of these risks could harm our business and operating results.

Integration of an acquired company's operations may present challenges.

The integration of an acquired company requires, among other things, coordination of administrative, sales and marketing, accounting and finance functions, and expansion of information and management systems. Integration may prove to be difficult

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due to the necessity of coordinating geographically separate organizations and integrating personnel with disparate business backgrounds and accustomed to different corporate cultures. We may not be able to retain key employees of an acquired company. Additionally, the process of integrating a new product or service may require a disproportionate amount of time and attention of our management and financial and other resources. Any difficulties or problems encountered in the integration of a new product or service could have a material adverse effect on our business. The integration of an acquired company may cost more than we anticipate, and it is possible that we will incur significant additional unforeseen costs in connection with such integration, which may negatively impact our earnings. In addition, we may only be able to conduct limited due diligence on an acquired company's operations. Following an acquisition, we may be subject to unforeseen liabilities arising from an acquired company's past or present operations and these liabilities may be greater than the warranty and indemnity limitations that we negotiate. Any unforeseen liability that is greater than these warranty and indemnity limitations could have a negative impact on our financial condition.

Even if successfully integrated, there can be no assurance that our operating performance after an acquisition will be successful or will fulfill management's objectives.

The loss of one or more of our key personnel, or our failure to attract, integrate, and retain other highly qualified personnel, could harm our business.

We depend on the continued service and performance of our key personnel. We do not have long-term employment agreements with any of our officers or key employees. In addition, many of our key technologies and systems are custom-made for our business by our personnel. The loss of key personnel, including key members of our management team, as well as certain of our key marketing, sales, product development, or technology personnel, could disrupt our operations and have an adverse effect on our ability to grow our business. In addition, several of our key personnel have only recently been employed by us, and we are still in the process of integrating these personnel into our operations. Our failure to successfully integrate these key employees into our business could adversely affect our business. In particular, David Friend, our founder, chairman, and former President and Chief Executive Officer, announced in February 2014 that he would resign as an executive of the Company, and on December 4, 2014, we announced that our board of directors appointed Mohammad Ali as our new President and Chief Executive Officer. To the extent that Mr. Ali is not successfully integrated, our business could be negatively impacted. While our board of directors remains committed to our strategic direction, management transitions can be disruptive and result in loss of institutional focus and employee morale, making execution of business strategies more difficult.

To execute our growth plan, we must attract and retain highly qualified personnel. Competition for these employees is intense, and we may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. New hires require significant training and, in most cases, take significant time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals. Many of the companies with which we compete for experienced personnel have greater resources than we have. In addition, in making employment decisions, particularly in the internet and high-technology industries, job candidates often consider the value of the stock options that they are to receive in connection with their employment. In addition, employees may be more likely to leave us if the shares they own or the shares underlying their vested options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options, or if the exercise prices of the options that they hold are significantly above the market price of our common stock. If we fail to attract new personnel, or fail to retain and motivate our current personnel, our business and growth prospects could be severely harmed.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity, and teamwork fostered by our culture, and our business may be harmed.

We believe that our corporate culture has been a key contributor to our success. If we do not continue to develop our corporate culture as we grow and evolve, including maintaining our culture of transparency with our employees, it could harm our ability to foster the innovation, creativity, and teamwork that we believe that we need to support our growth. As our organization grows and we are required to implement more complex organizational structures, we may

find it increasingly difficult to maintain the beneficial aspects of our corporate culture, which could negatively impact our future success. In addition, the availability of a public market for our securities could create disparities of wealth among our employees, which could adversely impact relations among employees and our corporate culture in general.

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Unanticipated changes in effective tax rates or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our operating results and financial condition.

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities will be subject to the allocation of expenses in differing jurisdictions. Our future effective tax rates could be subject to volatility or adversely affected by a number of factors, including:

- changes in the valuation of our deferred tax assets and liabilities;
- expected timing and amount of the release of tax valuation allowances;
- expiration of, or detrimental changes in, research and development tax credit laws;
- tax effects of stock-based compensation;
- costs related to intercompany restructurings;
- changes in tax laws, regulations, accounting principles or interpretations thereof; or
- future earnings being lower than anticipated in countries where we have lower statutory tax rates and higher than anticipated earnings in countries where we have higher statutory tax rates.

In addition, we may be subject to audits of our income and sales taxes by the Internal Revenue Service and other foreign and state tax authorities. Outcomes from these audits could have an adverse effect on our operating results and financial condition.

Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.

As of December 31, 2014, we had federal, state, and foreign net operating loss carryforwards, or NOLs, of \$100.2 million, \$57.8 million, and \$11.5 million, respectively, available to offset future taxable income, which expire in various years through 2034 if not utilized. A lack of future taxable income would adversely affect our ability to utilize these NOLs before they expire. Under the provisions of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, substantial changes in our ownership may limit the amount of pre-change NOLs that can be utilized annually in the future to offset taxable income. Section 382 of the Internal Revenue Code, or Section 382, imposes limitations on a company's ability to use NOLs if a company experiences a more-than-50-percent ownership change over a three-year testing period. Based upon our analysis as of December 31, 2014, there was no ownership change experienced during 2014. If changes in our ownership occur in the future, our ability to use NOLs may be further limited. For these reasons, we may not be able to utilize a material portion of the NOLs, even if we achieve profitability. If we are limited in our ability to use our NOLs in future years in which we have taxable income, we will pay more taxes than if we were able to fully utilize our NOLs. This could adversely affect our operating results and the market price of our common stock.

We face many risks associated with our plans to expand internationally, which could harm our business, financial condition, and operating results.

We anticipate that our efforts to expand internationally will entail the marketing and advertising of our services and brand and the development of localized websites. We do not have substantial experience in selling our solutions in international markets or in conforming to the local cultures, standards, or policies necessary to successfully compete in those markets, and we must invest significant resources in order to do so. We may not succeed in these efforts or achieve our customer acquisition or other goals. For some international markets, customer preferences and buying behaviors may be different, and we may use business or pricing models that are different from our traditional subscription model to provide cloud backup and related services to customers. Our revenue from new foreign markets may not exceed the costs of establishing, marketing, and maintaining our international solutions, and therefore may not be profitable on a sustained basis, if at all.

In addition, conducting international operations subjects us to new risks that we have not generally faced in the U.S. These risks include:

- localization of our solutions, including translation into foreign languages and adaptation for local practices and regulatory requirements;

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lack of experience in other geographic markets;
strong local competitors;
cost and burden of complying with, lack of familiarity with, and unexpected changes in foreign legal and regulatory requirements, including consumer and data privacy laws;
difficulties in managing and staffing international operations;
fluctuations in currency exchange rates or restrictions on foreign currency;
potentially adverse tax consequences, including the complexities of transfer pricing, foreign value added or other tax systems, double taxation and restrictions, and/or taxes on the repatriation of earnings;
dependence on third parties, including channel partners with whom we do not have extensive experience;
compliance with the Foreign Corrupt Practices Act, economic sanction laws and regulations, export controls, and other U.S. laws and regulations regarding international business operations;
increased financial accounting and reporting burdens and complexities;
political, social, and economic instability abroad, terrorist attacks, and security concerns in general; and
reduced or varied protection for intellectual property rights in some countries.

Operating in international markets also requires significant management attention and financial resources. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability.

Our software contains encryption technologies, certain types of which are subject to U.S. and foreign export control regulations and, in some foreign countries, restrictions on importation and/or use. Any failure on our part to comply with encryption or other applicable export control requirements could result in financial penalties or other sanctions under the U.S. export regulations, including restrictions on future export activities, which could harm our business and operating results. Regulatory restrictions could impair our access to technologies that we seek for improving our solutions and may also limit or reduce the demand for our solutions outside of the U.S.

Risks Related to Intellectual Property

Assertions by a third party that our solutions infringe its intellectual property, whether or not correct, could subject us to costly and time-consuming litigation or expensive licenses.

There is frequent litigation in the software and technology industries based on allegations of infringement or other violations of intellectual property rights. Any such claims or litigation may be time-consuming and costly, divert management resources, require us to change our services, require us to credit or refund subscription fees, or have other adverse effects on our business. Many companies are devoting significant resources to obtaining patents that could affect many aspects of our business. Third parties may claim that our technologies or solutions infringe or otherwise violate their patents or other intellectual property rights. As we face increasing competition and become increasingly visible as a publicly-traded company, or if we become more successful, the possibility of new third-party claims may increase.

If we are forced to defend ourselves against intellectual property infringement claims, whether they have merit or are determined in our favor, we may face costly litigation, diversion of technical and management personnel, limitations on our ability to use our current websites and technologies, and an inability to market or provide our solutions. As a result of any such claim, we may have to develop or acquire non-infringing technologies, pay damages, enter into royalty or licensing agreements, cease providing certain services, adjust our marketing and advertising activities, or take other actions to resolve the claims. These actions, if required, may be costly or unavailable on terms acceptable to us, or at all.

Furthermore, we have licensed proprietary technologies from third parties that we use in our technologies and business, and we cannot be certain that the owners' rights in their technologies will not be challenged, invalidated, or circumvented. In

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addition to the general risks described above associated with intellectual property and other proprietary rights, we are subject to the additional risk that the seller of such technologies may not have appropriately created, maintained, or enforced their rights in such technology.

Our success depends in large part on our ability to protect and enforce our intellectual property rights. If we are not able to adequately protect our intellectual property and proprietary technologies to prevent use or appropriation by our competitors, the value of our brand and other intangible assets may be diminished, and our business may be adversely affected.

Our future success and competitive position depend in large part on our ability to protect our intellectual property and proprietary technologies. We rely on a combination of trademark, patent, copyright, and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights, all of which provide only limited protection and may not now or in the future provide us with a competitive advantage.

CARBONITE is a registered trademark in the U.S. and in over 30 other countries, including countries in the European Union. Carbonite also has additional registrations and pending applications for additional marks in the U.S. and other countries, including but not limited to “Carbonite The Better Backup Plan”, “Back it up. Get it back”, “Because Your Life is On Your Computer”, “Carbonite” and the Green Dot Logo, Carbonite Lock Logo, Phanfare, Zmanda and the Z logo and Chinese character representations for Carbonite. We cannot assure you that any future trademark registrations will be issued for pending or future applications or that any registered trademarks will be enforceable or provide adequate protection of our proprietary rights. We currently have eight issued patents and 18 pending patent applications in the U.S. and internationally. We cannot assure you that any patents will issue from any such patent applications, that patents that issue from such applications will give us the protection that we seek, or that any such patents will not be challenged, invalidated, or circumvented. Any patents that may issue in the future from our pending or future patent applications may not provide sufficiently broad protection and may not be enforceable in actions against alleged infringers. To counter infringement or unauthorized use, we may be required to file patent infringement claims, which can be expensive and time-consuming to litigate. In addition, in an infringement proceeding, a court may decide that a patent of ours is not valid or is unenforceable, or may refuse to stop others from using the technology at issue on the grounds that our patent(s) do not cover such technology. An adverse determination of any litigation or defense proceedings could put one or more of our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not being issued.

There can be no assurance that the steps that we take will be adequate to protect our technologies and intellectual property, that our trademark and patent applications will lead to registered trademarks or issued patents, that others will not develop or patent similar or superior technologies, products, or services, or that our trademarks, patents, and other intellectual property will not be challenged, invalidated, or circumvented by others. Furthermore, effective trademark, patent, copyright, and trade secret protection may not be available in every country in which our services are available or where we have employees or independent contractors. In addition, the legal standards relating to the validity, enforceability, and scope of protection of intellectual property rights in internet-related industries are uncertain and still evolving. If our efforts to protect our technologies and intellectual property are inadequate, the value of our brand and other intangible assets may be diminished and competitors may be able to mimic our solutions and methods of operations. Any of these events could have a material adverse effect on our business, financial condition, and operating results.

Confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and proprietary information. Failure to protect our proprietary information could make it easier for third parties to compete with our solutions and harm our business.

We have devoted substantial resources to the development of our proprietary technologies and related processes. In order to protect our proprietary technologies and processes, we rely in part on trade secret laws and confidentiality agreements with our employees, licensees, independent contractors, and other advisors. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover our trade secrets, in which case we would not be able to assert trade secret rights, or develop similar technologies and processes. Further, laws in certain jurisdictions may afford little or no trade secret protection, and any changes in, or unexpected

interpretations of, the intellectual property laws in any country in which we operate may compromise our ability to enforce our intellectual property rights. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure or inability to obtain or maintain trade secret protection or otherwise protect our proprietary rights could adversely affect our business.

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Our use of “open source” software could negatively affect our ability to sell our solutions and subject us to possible litigation.

A portion of the technologies licensed by us to our customers incorporates so-called “open source” software, and we may incorporate open source software in the future. Such open source software is generally licensed by its authors or other third parties under open source licenses. These licenses may subject us to certain unfavorable conditions, including requirements that we offer our solutions that incorporate the open source software for no cost, that we make publicly available source code for modifications or derivative works we create based upon, incorporating, or using the open source software, and/or that we license such modifications or derivative works under the terms of the particular open source license. Additionally, if a third-party software provider has incorporated open source software into software that we license from such provider, we could be required to disclose any of our source code that incorporates or is a modification of such licensed software. If an author or other third party that distributes open source software that we use or license were to allege that we had not complied with the conditions of the applicable license, we could be required to incur significant legal expenses defending against such allegations and could be subject to significant damages, enjoined from the sale of our solutions that contained the open source software, and required to comply with the foregoing conditions. Any of the foregoing could disrupt the distribution and sale of our solutions and harm our business.

We rely on third-party software, including server software and licenses from third parties to use patented intellectual property, that is required to develop and provide our solutions.

We rely on software licensed from third parties to develop and offer our solutions, including server software from Microsoft and other patented third-party technologies. In addition, we may need to obtain future licenses from third parties to use intellectual property associated with the development of our solutions, which might not be available to us on acceptable terms, or at all. Any loss of the right to use any software required for the development and maintenance of our solutions could result in delays in the provision of our solutions until equivalent technology is either developed by us, or, if available from others, is identified, obtained, and integrated, which delay could harm our business. Any errors or defects in third-party software could result in errors or a failure of our solutions, which could harm our business.

If we are unable to protect our domain names, our reputation, brand, customer base, and revenue, as well as our business and operating results, could be adversely affected.

We have registered domain names for websites, or URLs, that we use in our business, such as www.carbonite.com. If we are unable to maintain our rights in these domain names, our competitors or other third parties could capitalize on our brand recognition by using these domain names for their own benefit. In addition, although we own the Carbonite domain name under various global top level domains such as .com and .net, as well as under various country-specific domains, we might not be able to, or may choose not to, acquire or maintain other country-specific versions of the Carbonite domain name or other potentially similar URLs. Domain names similar to ours have already been registered in the U.S. and elsewhere, and our competitors or other third parties could capitalize on our brand recognition by using domain names similar to ours. The regulation of domain names in the U.S. and elsewhere is generally conducted by internet regulatory bodies and is subject to change. If we lose the ability to use a domain name in a particular country, we may be forced to either incur significant additional expenses to market our solutions within that country, including the development of a new brand and the creation of new promotional materials, or elect not to sell our solutions in that country. Either result could substantially harm our business and operating results. Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars, or modify the requirements for holding domain names. As a result, we may not be able to acquire or maintain the domain names that utilize the name Carbonite in all of the countries in which we currently conduct or intend to conduct business. Further, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights varies among jurisdictions and is unclear in some jurisdictions. We may be unable to prevent third parties from acquiring and using domain names that infringe, are similar to, or otherwise decrease the value of, our brand or our trademarks. Protecting and enforcing our rights in our domain names and determining the rights of others may require litigation, which could result in substantial costs, divert management attention, and not be decided favorably to us.

Material defects or errors in our software could harm our reputation, result in significant costs to us, and impair our ability to sell our solutions.

The software applications underlying our solutions are inherently complex and may contain material defects or errors, particularly when first introduced or when new versions or enhancements are released. We have from time to time found defects or errors in our solutions, and new defects or errors in our existing solutions may be detected in the future by us or our customers. The costs incurred in correcting such defects or errors may be substantial and could harm our operating results. In addition, we rely on hardware purchased or leased and software licensed from third parties to offer our solutions. Any defects

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in, or unavailability of, our or third-party software or hardware that cause interruptions to the availability of our solutions could, among other things:

- cause a reduction in revenue or delay in market acceptance of our solutions;
- require us to issue credits or refunds to our customers or expose us to claims for damages;
- cause us to lose existing customers and make it more difficult to attract new customers;
- divert our development resources or require us to make extensive changes to our solutions or software, which would increase our expenses;
- increase our technical support costs; and
- harm our reputation and brand.

Risks Related to Ownership of our Common Stock

We may be subject to a proxy contest that would be disruptive to our business, may require us to incur significant additional costs and threatens to adversely affect the company's operations and results.

We have received notices of director nominations from Engine Capital, L.P. and j2. If Engine Capital and j2 do not withdraw their nominations, a proxy contest is likely to occur. A proxy contest could adversely affect our operations and results because:

- it would be disruptive, costly and time-consuming, and divert the attention of our Board of Directors, management and employees;

- the perceived uncertainties regarding the future of the Company related to a proxy contest, including, but not limited to, uncertainties related to our new CEO and Board of Directors, may result in the loss of potential business opportunities and may make it more difficult to attract and retain qualified personnel, customers or other business partners;

- if individuals are elected to our Board of Directors with a specific agenda, it may adversely affect our ability to effectively implement our business strategy and create additional value for our stockholders;

- the expenses for legal and advisory fees and the administrative and associated costs incurred in connection with a potential proxy contest may be substantial; and

- we may choose to initiate, or may become subject to, litigation as a result of the potential proxy contest or matters resulting from the potential proxy contest, which could serve as a further distraction to our Board of Directors, management and employees and could require us to incur significant additional costs, and, moreover, if determined adversely to us, these lawsuits could harm our business and have a material adverse effect on our results of operations.

We believe the future trading price of our common stock could be subject to wide price fluctuations or otherwise adversely affected based on the events, risks and uncertainties described above.

Our stock price may be volatile due to fluctuations in our operating results and other factors, each of which could cause our stock price to decline.

Shares of our common stock were sold in our initial public offering in August 2011 at a price of \$10.00 per share, and our common stock has subsequently traded as high as \$21.10 and as low as \$5.75. An active, liquid, and orderly market for our common stock may not be developed or sustained, which could depress the trading price of our common stock. The market price for shares of our common stock could be subject to significant fluctuations in response to various factors, some of which are beyond our control. Some of the factors that may cause the market

price for shares of our common stock to fluctuate include:

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fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;

actual or anticipated fluctuations in our key operating metrics, financial condition, and operating results;

loss of existing customers or inability to attract new customers;

actual or anticipated changes in our growth rate;

announcements of technological innovations or new offerings by us or our competitors;

our announcement of actual results for a fiscal period that are lower than projected or expected or our announcement of revenue or earnings guidance that is lower than expected;

changes in estimates of our financial results or recommendations by securities analysts;

failure of any of our solutions to achieve or maintain market acceptance;

changes in market valuations of similar companies;

success of competitive products or services;

changes in our capital structure, such as future issuances of securities or the incurrence of debt;

announcements by us or our competitors of significant products or services, contracts, acquisitions, or strategic alliances;

regulatory developments in the U.S. or foreign countries;

actual or threatened litigation involving us or our industry;

additions or departures of key personnel;

general perception of the future of the cloud backup market or our solutions;

share price and volume fluctuations attributable to inconsistent trading volume levels of our shares;

sales of our shares of common stock by our existing stockholders; and

changes in general economic, industry, and market conditions.

In addition, the stock market in general, and the market for internet-related companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. Such litigation, if instituted against us, could result in very substantial costs, divert our management's attention and resources, and harm our business, financial condition, and operating results. In addition, recent fluctuations in the financial and capital markets have resulted in volatility in securities prices.

If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, our ability to operate our business, and our investors views of us.

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be evaluated frequently. As part of our process of documenting and testing our internal control over financial reporting, we may identify areas for further attention and improvement. Implementing any appropriate changes to our internal controls may distract our officers and employees, entail substantial costs to modify our existing processes, and take significant time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our

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business. In addition, investors perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our solutions to new and existing customers.

Our failure to raise additional capital or generate the cash flows necessary to expand our operations and invest in our business could reduce our ability to compete successfully.

Although we currently anticipate that our available funds will be sufficient to meet our cash needs for at least the next 12 months, we may require additional financing in the future. Our ability to obtain financing will depend, among other things, on our development efforts, business plans, operating performance and condition of the capital markets at the time we seek financing. If we need to raise additional funds, we may not be able to obtain debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the per share value of our common stock could decline. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop or enhance our solutions;
- continue to expand our development, sales, and marketing organizations;
- acquire complementary technologies, products, or businesses;
- expand our operations in the U.S. or internationally;
- hire, train, and retain employees;
- respond to competitive pressures or unanticipated working capital requirements; or
- continue our operations.

Future sales of shares of our common stock by existing stockholders could depress the market price of our common stock.

If our existing stockholders sell, or indicate an intent to sell, a substantial number of shares of our common stock in the public market, the trading price of our common stock could decline significantly. Two of our largest shareholders are venture capital funds, which are typically structured to have a finite life. As these venture capital funds approach or pass the respective terms of their funds, their decision to sell or hold our common stock may be based not only on the underlying investment merits of our securities but also on the requirements of their internal fund structure.

Additionally, our directors, executive officers, and holders of more than 5% of our common stock, and their respective affiliates beneficially own approximately 19.0 million shares of our common stock, which represents 67.2% of our issued and outstanding shares of common stock as of December 31, 2014. If these shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline substantially.

Our directors, executive officers, and principal stockholders have substantial control over us and could delay or prevent a change in corporate control.

Our directors, executive officers, and holders of more than 5% of our common stock, together with their affiliates, beneficially hold a majority of our outstanding shares of common stock and have the ability to control the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation, or sale of all or substantially all of our assets. In addition, these stockholders, acting together, have the ability to control or influence the management and affairs of our company. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a change in control of our company.

We do not currently intend to pay dividends on our common stock and, consequently, your ability to achieve a return on your investment will depend on appreciation in the price of our common stock.

We have never declared or paid any cash dividends on our common stock and do not intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth and continuing operations. Therefore, you are not likely to receive any dividends on your shares of common stock for the foreseeable future and the success of an

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investment in shares of our common stock will depend upon any future appreciation in their value. Our common stock may not appreciate in value or even maintain the price at which our stockholders have purchased their shares. Anti-takeover provisions contained in our certificate of incorporation, bylaws, Rights Agreement as well as provisions of Delaware law, could impair a takeover attempt.

Our certificate of incorporation and bylaws contain provisions that could have the effect of delaying or preventing changes in control or changes in our management without the consent of our board of directors. These provisions include:

- a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board of directors;
- no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death, or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;
- the ability of our board of directors to determine to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;
- a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
- the requirement that a special meeting of stockholders may be called only by the chairman of the board of directors, the chief executive officer, or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action;
- limiting the liability of, and providing indemnification to, our directors and officers;
- controlling the procedures for the conduct and scheduling of stockholder meetings;
- providing the board of directors with the express power to postpone previously scheduled annual meetings of stockholders and to cancel previously scheduled special meetings of stockholders;
- providing that directors may be removed prior to the expiration of their terms by stockholders only for cause; and advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of us.

We have also adopted a Rights Agreement, pursuant to which "rights" are issued to all Company common stockholders that, if activated upon an attempted unfriendly acquisition, would deter, and thereby minimize the risk of, any potential hostile takeover. These provisions, alone or together, could delay hostile takeovers and changes in control of our company or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal executive offices are located in Boston, Massachusetts, in a 52,588, square-foot facility, under a lease expiring on December 31, 2024. We also have our former corporate headquarters, which is a 39,775 square-foot facility in Boston, Massachusetts, under a lease and sublease expiring on December 31, 2016, and a 22,592 square-foot customer support facility in Lewiston, Maine under a lease expiring on June 1, 2016. We also maintain small offices in Sunnyvale, California, Munich, Germany and Viersen, Germany.

Our data centers are located in Massachusetts and Arizona. Our data center leases expire between September 2015 and April 2018. Our Somerville, Massachusetts data center arrangement ended on January 31, 2015.

ITEM 3. LEGAL PROCEEDINGS

In August 2010, Oasis Research, LLC, or Oasis Research, filed a lawsuit against us and several of our competitors and other online technology companies in the U.S. District Court for the Eastern District of Texas, alleging that our cloud backup storage services, and the other companies' products or services, infringe certain of Oasis Research's patents. Oasis Research sought an award for damages in an unspecified amount. A trial was held in March 2013 and a jury verdict was returned against Oasis Research that found all of the asserted patents invalid. On January 8, 2015, the magistrate judge granted Oasis Research's Motion for Judgment as a Matter of Law under Rule 50(b) and Alternative Request for a New Trial under Rule 59(a). The Company is currently reviewing the order. We are not able to assess with certainty the outcome of this lawsuit or the amount or range of potential damages or future payments associated with this lawsuit at this time.

While we intend to defend ourselves and prosecute our counterclaims vigorously, any litigation is subject to inherent uncertainties, and there can be no assurance that the expenses associated with defending these lawsuits or their resolution will not have a material adverse impact on our business, operations, financial condition, or cash flows. In addition to this lawsuit, from time to time, we have been and may become involved in legal proceedings arising in the ordinary course of our business. Although the results of litigation and claims cannot be predicted with certainty, we are not presently involved in any other legal proceeding in which the outcome, if determined adversely to us, would be expected to have a material adverse effect on our business, operating results, or financial condition. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

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PART II

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

Our common stock is traded on The NASDAQ Global Market under the symbol "CARB." The following table shows the high and low sale prices per share of our common stock as reported on The NASDAQ Global Market for the periods indicated:

	2014		2013	
	High	Low	High	Low
First Quarter	\$13.80	\$9.07	\$11.03	\$9.12
Second Quarter	\$12.00	\$8.26	\$13.50	\$9.54
Third Quarter	\$12.66	\$9.17	\$16.50	\$12.15
Fourth Quarter	\$14.89	\$9.55	\$16.02	\$10.11

On February 27, 2015, the closing price as reported on The NASDAQ Global Market, of our common stock was \$15.07 per share. As of February 27, 2015, we had approximately 42 holders of record of our common stock. This does not include the number of persons whose stock is held in nominee or "street" name accounts through brokers. We have never declared or paid, and do not anticipate declaring or paying, any cash dividends on our common stock. Any future determination as to the declaration and payment of dividends, will be at the discretion of our board of directors and will depend on then existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects, and other factors that our board of directors may deem relevant. Our equity plan information required by this item is incorporated by reference to the information in Part III, Item 12 of this Annual Report on Form 10-K.

Performance Graph

The following performance graph compares the cumulative total return to holders of our common stock for the period from August 11, 2011, the date our common stock commenced trading on The NASDAQ Global Market, through December 31, 2014, against the cumulative total return of The NASDAQ Composite Index and The NASDAQ-100 Technology Sector Index.

The comparison assumes that \$100.00 was invested in our common stock, The NASDAQ Composite Index and The NASDAQ-100 Technology Sector Index. The graph assumes the initial value of our common stock on August 11, 2011 was the closing sale price on that day of \$12.35 per share and not the initial offering price to the public of \$10.00 per share. The performance shown on the graph below is based on historical results and is not intended to suggest future performance.

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This performance graph shall not be deemed “soliciting material” or to be “filed” with the Securities and Exchange Commission for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Carbonite, Inc. under the Securities Act of 1933, as amended.

Recent Sales of Unregistered Securities

There were no unregistered sales of our equity securities during the twelve months ended December 31, 2014.

Repurchases

Neither we nor any "affiliated purchaser" repurchased any shares of our equity securities during the year ended December 31, 2014.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

You should read the following selected consolidated financial and other data below in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements, related notes, and other financial information included in this Annual Report on Form 10-K. The selected consolidated financial and other data in this section are not intended to replace the consolidated financial statements and are qualified in their entirety by the consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

The consolidated statements of operations data for the years ended December 31, 2014, 2013, and 2012 and the consolidated balance sheets data as of December 31, 2014 and 2013 are derived from our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data for the years ended December 31, 2011 and 2010 and the consolidated balance sheets data as of December 31, 2012, 2011 and 2010 are derived from our audited consolidated financial statements not included in this Annual Report on Form 10-K. Historical results are not necessarily indicative of the results to be expected in the future.

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	Years Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands, except share and per share data)				
Consolidated statements of operations data:					
Revenue	\$122,620	\$107,194	\$84,043	\$60,512	\$38,563
Cost of revenue (1)	38,567	34,881	29,060	23,202	16,284
Gross profit	84,053	72,313	54,983	37,310	22,279
Operating expenses (1):					
Research and development	24,132	20,919	19,925	16,511	10,868
General and administrative	17,862	14,275	9,928	6,631	4,209
Sales and marketing	49,882	47,349	42,719	37,722	33,098
Restructuring charges	762	322	1,345	—	—
Total operating expenses	92,638	82,865	73,917	60,864	48,175
Loss from operations	(8,585)	(10,552)	(18,934)	(23,554)	(25,896)
Interest and other (expense) income, net	(398)	2)	38)	41)	133)
Loss before income taxes	(8,983)	(10,550)	(18,896)	(23,513)	(25,763)
Provision for income taxes	(367)	(55)	(40)	(23)	—)
Net loss	(9,350)	(10,605)	(18,936)	(23,536)	(25,763)
Accretion of redeemable convertible preferred stock	—	—	—	(128)	(210)
Net loss attributable to common stockholders	\$(9,350)	\$(10,605)	\$(18,936)	\$(23,664)	\$(25,973)
Basic and diluted net loss per share attributable to common stockholders	\$(0.35)	\$(0.41)	\$(0.74)	\$(1.84)	\$(5.90)
Weighted-average number of common shares used in computing basic and diluted net loss per share	26,816,879	26,166,554	25,503,068	12,841,233	4,399,137

(1) Stock-based compensation included in the consolidated statements of operations data above was as follows:

	Years Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Cost of revenue	\$539	\$508	\$440	\$207	\$45
Research and development	1,285	955	1,199	511	171
General and administrative	3,216	2,250	1,579	346	227
Sales and marketing	1,025	1,064	913	381	99
As of December 31,					
	2014	2013	2012	2011	2010
	(in thousands)				
Consolidated balance sheet data:					
Cash	\$46,084	\$50,392	\$40,341	\$59,842	\$13,855
Working capital (deficit)	(23,767)	(11,080)	(11,685)	18,838)	(12,381)
Total assets	131,754	109,161	100,925	99,606	40,941
Deferred revenue, including current portion	91,424	84,000	75,206	59,696	38,722
Total liabilities	117,216	96,340	86,994	72,004	47,834
Preferred stock warrant liability	—	—	—	—	82
Redeemable and convertible stock	—	—	—	—	68,730
Total stockholders' equity (deficit)	14,538	12,821	13,931	27,602	(75,623)

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	Years Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands, except percentage data)				
Key metrics:					
Bookings (1)	\$128,183	\$115,988	\$98,488	\$80,900	\$54,141
Annual retention rate (2)	83	% 84	% 84	% 82	% 83
Renewal rate (3)	80	% 80	% 82	% 82	% 81
Free cash flow (4)	\$15,072	\$5,974	\$(4,065)	\$(5,972)	\$(12,204)

(1) We define bookings as revenue recognized during the period plus the change in total deferred revenue net of foreign exchange (excluding deferred revenue recorded in connection with acquisitions) during the same period.

(2) We define annual retention rate as the percentage of customers on the last day of the prior year who remain customers on the last day of the current year.

(3) We define renewal rate for a period as the percentage of customers who renew annual or multi-year subscriptions that expire during the period presented.

(4) We define free cash flow as net cash provided by (used in) operating activities, less capital expenditures, and adjusted for the cash portion of the lease exit charge, payments related to corporate headquarter relocation, acquisition-related payments, tender offer-related expenses, and CEO transition payments.

Bookings and free cash flow are financial data that are not calculated in accordance with GAAP. The tables below provide reconciliation of bookings and free cash flow to revenue and cash provided by (used in) operating activities, respectively, the most directly comparable financial measures calculated and presented in accordance with GAAP.

Our management uses annual retention rate to determine the stability of our customer base and to evaluate the lifetime value of our customer relationships. As customers' annual and multi-year subscriptions come up for renewal throughout the calendar year based on the dates of their original subscriptions, measuring retention on a trailing twelve month basis at the end of each quarter provides our management with useful and timely information about the stability of our customer base. Management uses renewal rate to monitor trends in customer renewal activity.

Our management uses bookings as a proxy for cash receipts. Bookings represent the aggregate dollar value of customer subscriptions received by us during a period. We initially record a subscription fee as deferred revenue and then recognize it as revenue ratably, on a daily basis, over the life of the subscription period. Management uses free cash flow as a measure of our operating performance; for planning purposes, including the preparation of our annual operating budget; to allocate resources to enhance the financial performance of our business; to evaluate the effectiveness of our business strategies; to provide consistency and comparability with past financial performance; to determine capital requirements; to facilitate a comparison of our results with those of other companies; and in communications with our board of directors concerning our financial performance. We also use free cash flow as a factor when determining management's incentive compensation. Management believes that the use of free cash flow provides consistency and comparability with our past financial performance, facilitates period to period comparisons of operations, and also facilitates comparisons with other peer companies, many of which use similar non-GAAP financial measures to supplement their GAAP results.

Although bookings and free cash flow are frequently used by investors and securities analysts in their evaluations of companies, bookings and free cash flow have limitations as analytical tools, and you should not consider them in isolation or as substitutes for analysis of our results of operations as reported under GAAP. Some of these limitations are:

- bookings do not reflect our receipt of payment from subscribers;

- free cash flow does not reflect our future requirements for contractual commitments to vendors;

- free cash flow does not reflect the non-cash component of employee compensation or depreciation and amortization of property and equipment; and

-

other companies in our industry may calculate bookings or free cash flow or similarly titled measures differently than we do, limiting their usefulness as comparative measures.

The following tables present reconciliations of our bookings and free cash flow to revenue and cash provided by (used in) operating activities, respectively, the most directly comparable financial measures calculated and presented in accordance with GAAP.

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	Years Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Revenue	\$122,620	\$107,194	\$84,043	\$60,512	\$38,563
Add change in deferred revenue, net of foreign exchange (excluding acquisition)	5,563	8,794	14,445	20,388	15,578
Bookings	\$128,183	\$115,988	\$98,488	\$80,900	\$54,141
	Years Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Cash provided by (used in) operating activities	\$22,678	\$14,625	\$9,195	\$7,572	\$(1,552)
Add cash portion of lease exit charge	230	1,150	157	—	—
Add payments related to corporate headquarter relocation	3,872	—	—	—	—
Add acquisition-related payments	2,053	—	—	—	—
Add tender offer-related payments	100	—	—	—	—
Add CEO transition payments	634	—	—	—	—
Subtract capital expenditures	(14,495)	(9,801)	(13,417)	(13,544)	(10,652)
Free cash flow	\$15,072	\$5,974	\$(4,065)	\$(5,972)	\$(12,204)

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. The following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Annual Report on Form 10-K, particularly in "Risk Factors."

Overview

We are a provider of cloud and hybrid backup solutions. Our solutions provide powerful features packaged in a simple, cost-effective and secure manner, and are designed to address the specific needs of small and medium sized businesses (SMBs) and consumers.

In 2005, we began development of our cloud backup solution and raised our first capital from investors. We sold the first Carbonite subscription in 2006. In 2010, we introduced our small business solution and expanded our management team to better focus on our small business and consumer markets. We surpassed 100,000 subscribers in 2008, 500,000 subscribers in 2009, and 1,000,000 subscribers in early 2011. As of December 31, 2014, we had subscribers in more than 100 countries, with subscribers based in the U.S. representing approximately 94% of our total revenue for 2014.

One of our largest individual expenses is advertising for customer acquisition, which is recorded as sales and marketing expense. This is comprised of radio advertising, online display advertising, television, print advertising, paid search, direct marketing, and other expenses. Our total advertising expense in 2014, 2013, and 2012 was \$18.0 million, \$25.2 million, and \$24.1 million, respectively. We generally spend more on advertising in the first and third quarters of each year based on the seasonality of customer purchasing patterns and fluctuations in advertising rates. We currently have a distribution strategy designed to sell large volumes of our solutions through our sales channel relationships including resellers.

As we grow our business we continue to invest in additional storage and infrastructure. Our capital expenditures in 2014, 2013, and 2012 were \$14.5 million, \$9.8 million, and \$13.4 million, respectively.

Our revenue has grown from \$84.0 million in 2012 to \$107.2 million in 2013 and \$122.6 million in 2014. At the same time, our total operating costs have grown from \$73.9 million in 2012 to \$82.9 million in 2013 and \$92.6 million in

2014, principally as a result of our investment in customer acquisition and research and development. We expect to continue to devote

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substantial resources to customer acquisition, improving our technologies, and expanding our solutions. In addition, we expect to invest heavily in our operations to support anticipated growth and public company reporting and compliance obligations. We defer revenue over our customers' subscription periods, but expense marketing costs as incurred. As a result of these factors, we expect to continue to incur GAAP operating losses on an annual basis for the foreseeable future.

Our Business Model

We evaluate the profitability of a customer relationship over its lifecycle because of the nature of our business model. We generally incur customer acquisition costs and capital equipment costs in advance of subscriptions while recognizing revenue ratably over the terms of the subscriptions. As a result, a customer relationship may not be profitable or result in positive cash flow at the beginning of the subscription period, even though it may be profitable or result in positive cash flow over the life of the customer relationship. While we offer monthly, annual and multi-year subscription plans, a significant majority of our customers are currently on annual subscription plans. The annual or multi-year commitments of our customers enhance management's visibility of our revenue, and charging customers at the beginning of the subscription period provides working capital.

Key Business Metrics

Our management regularly reviews a number of financial and operating metrics, including the following key metrics, to evaluate our business:

Bookings. We calculate bookings as revenue recognized during a particular period plus the change in total deferred revenue net of foreign exchange (excluding deferred revenue recorded in connection with acquisitions) during the same period. Our management uses this measure as a proxy for cash receipts. Bookings represent the aggregate dollar value of customer subscriptions received by us during a period. We initially record a subscription fee as deferred revenue and then recognize it as revenue ratably, on a daily basis, over the life of the subscription period.

Annual retention rate. We calculate annual retention rate as the percentage of customers on the last day of the prior year who remain customers on the last day of the current year. Our management uses these measures to determine the stability of our customer base and to evaluate the lifetime value of our customer relationships.

Renewal rate. We define renewal rate for a period as the percentage of customers who renew annual or multi-year subscriptions that expire during the period presented. Our management uses this measure to monitor trends in customer renewal activity.

Free cash flow. We define free cash flow as cash provided by operating activities, less purchases of property and equipment plus acquisition and other non-recurring charges. Our management uses free cash flow to assess our business performance and evaluate the amount of cash generated by our business.

Subscription renewals may vary during the year based on the date of our customers' original subscriptions. As we recognize subscription revenue ratably over the subscription period, this generally has not resulted in a material seasonal impact on our revenue but may result in material monthly and quarterly variances in one or more of the key business metrics described above.

Performance Highlights

The following table presents our performance highlights for the periods presented:

	Years Ended December 31,			
	2014	2013	2012	
	(in thousands, except percentage data)			
Key metrics:				
Bookings	\$128,183	\$115,988	\$98,488	
Annual retention rate	83	% 84	% 84	%
Renewal rate	80	% 80	% 82	%
Free cash flow	\$15,072	\$5,974	\$(4,065))

Our total bookings increased over the periods presented, and we continue to invest in customer acquisition in an effort to drive continued growth, with bookings for our small business solutions representing 31% of total bookings for the

year ended December 31, 2014, up from 27% in the year ended December 31, 2013.

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Free cash flow for the year ended December 31, 2014 increased by \$9.1 million, and \$19.1 million compared to the years ended December 31, 2013, and December 31, 2012, respectively. Our increase in free cash flow was principally driven by growth in bookings and increased efficiencies in our business model.

Key Components of our Consolidated Statements of Operations

Revenue

We derive our revenue principally from subscription fees related to our service solutions. We typically charge a customer's credit card the full price of the subscription at the commencement of the subscription period and at each renewal date, unless the customer decides not to renew the subscription. We initially record a customer subscription fee as deferred revenue and then recognize it as revenue ratably, on a daily basis, over the life of the subscription period.

Cost of revenue

Cost of revenue consists primarily of costs associated with our data center operations and customer support centers, including wages and benefits for personnel, depreciation of equipment, amortization of developed technology, rent, utilities and broadband, equipment maintenance, software license fees, and allocated overhead. The expenses related to hosting our services and supporting our customers are related to the number of customers and the complexity of our services and hosting infrastructure. On a cost-per-GB stored basis, our costs have decreased due to decreases in storage prices and greater efficiency in our data center operations. We have also experienced a downward trend in the cost of storage equipment and broadband service, which we expect will continue in the future. We expect these expenses to increase in absolute dollars, but decrease as a percentage of revenue due to improved efficiencies in supporting customers.

Gross profit and gross margin

Our gross margins have expanded due to price increases for our consumer solutions, the introduction of higher priced solutions targeting both small businesses and consumers, a downward trend in the cost of storage equipment and services, and efficiencies of our customer support personnel in supporting our customers. We expect these trends to continue.

Operating expenses

Research and development. Research and development expenses consist primarily of wages and benefits for development personnel, consulting fees, rent, and depreciation. We have focused our research and development efforts on both improving ease of use and functionality of our existing solutions and developing new solutions. The majority of our research and development employees are located at our corporate headquarters in the U.S. We expect that research and development expenses will increase in absolute dollars on an annual basis as we continue to enhance and expand our services, but decrease as a percentage of revenue over time, as we expect to grow our revenue at a faster rate.

General and administrative. General and administrative expenses consist primarily of wages and benefits for management, finance, accounting, human resources, legal and other administrative personnel, legal and accounting fees, insurance, and other corporate expenses. We expect that general and administrative expenses will increase in absolute dollars on an annual basis as we continue to add personnel and enhance our internal information systems in connection with the anticipated growth of our business and incur costs related to operating as a public company.

Sales and marketing. Sales and marketing expenses consist primarily of advertising costs, wages and benefits for sales and marketing personnel, creative expenses for advertising programs, credit card fees, commissions paid to third-party partners and affiliates, and the cost of providing free trials. The largest component of sales and marketing expense is advertising for customer acquisition, principally radio, online, television and print advertisements. Online search costs consist primarily of pay-per-click payments to search engine operators. Advertising costs are expensed as incurred. To date, marketing and advertising costs have been incurred principally in the U.S., but we may increase our marketing and advertising expenditures in other countries. We expect that we will continue to commit significant resources to our sales and marketing efforts to grow our business and awareness of our brand and solutions. We expect that sales and marketing expenses will continue to increase in absolute dollars on an annual basis, but decrease as a percentage of revenue, as we expect to grow our revenue at a faster rate.

Restructuring charges. Restructuring charges consist of lease exit charges related to our corporate headquarter relocation, costs associated with our data center optimization program, the March 2012 closure of our Boston, Massachusetts data center and charges incurred related to the restructuring of our Carbonite China operations, which are now dormant. See Note 12—Restructuring to our consolidated financial statements included in this Annual Report on Form 10-K for additional information.

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Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles generally accepted in the U.S., or GAAP. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions, and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances, but all such estimates and assumptions are inherently uncertain and unpredictable. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from those estimates and assumptions, and it is possible that other professionals, applying their own judgment to the same facts and circumstances, could develop and support alternative estimates and assumptions that would result in material changes to our operating results and financial condition. Our most critical accounting policies are summarized below. See Note 2—Summary of Significant Accounting Policies to our consolidated financial statements included in this Annual Report on Form 10-K for additional information about these critical accounting policies, as well as a description of our other significant accounting policies.

Revenue recognition

We derive revenue from cloud backup subscription services. These services are standalone independent service solutions, which are generally contracted for a one- to three-year term. Subscription arrangements include access to use our services via the internet. We recognize revenue in accordance with the Financial Accounting Standards Codification (ASC) 605-10, Overall Revenue Recognition. Subscription revenue is recognized ratably on a daily basis upon activation of service over the subscription period, when persuasive evidence of an arrangement with a customer exists, the subscription period has been activated, the price is fixed or determinable, and collection is reasonably assured. Deferred revenue represents payments received from customers for subscription services prior to recognizing the revenue related to those payments.

Business Combinations

In accordance with ASC 805, Business Combinations, we recognize the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. Determining these fair values requires management to make significant estimates and assumptions, especially with respect to intangible assets.

The fair value of identifiable intangible assets is based on detailed valuations that use information and assumptions provided by management, which reflect management's best estimates of inputs and assumptions that a market participant would use. Our identifiable intangible assets acquired consist of developed technology, customer relationships, tradenames, and non-compete agreements. Developed technology consists of products that have reached technological feasibility and tradenames represent acquired company and product names. Customer relationships represent the underlying relationships and agreements with customers of the acquired company's installed base. Non-compete agreements represent the protection against the loss of business and resultant cash flows from direct competition.

Goodwill and acquired intangible assets

We record goodwill when consideration paid in a business acquisition exceeds the fair value of the net assets acquired. Our estimates of fair value are based upon assumptions believed to be reasonable at that time, but that are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and unanticipated events or circumstances may occur, that may affect the accuracy or validity of such assumptions, estimates or actual results.

Goodwill is not amortized, but rather is tested for impairment annually or more frequently at the reporting unit level if facts and circumstances warrant a review. We have determined that there is a single reporting unit for the purpose of conducting this goodwill impairment assessment. For purposes of assessing potential impairment, we estimate the fair value of the reporting unit (based on our market capitalization) and compare this amount to the carrying value of the reporting unit (as reflected by our total stockholders' equity). If we determine that the carrying value of the reporting unit exceeds its fair value, an impairment charge would be required. Our annual goodwill impairment test is at November 30 of each year. To date, we have not identified any impairment to goodwill.

Intangible assets acquired in a business combination are recorded at their estimated fair values at the date of acquisition. We amortize acquired intangible assets over their estimated useful lives based on the pattern of

consumption of the economic benefits or, if that pattern cannot be readily determined, on a straight-line basis. We review our intangible assets with definite lives for impairment when events or changes in circumstances indicate that the carrying amount of any of these assets may not be recoverable. We have not identified any impairment of our long-lived assets as of December 31, 2014, 2013, and 2012.

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Income taxes

We provide for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization. We account for uncertain tax positions recognized in our consolidated financial statements by prescribing a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Due to a history of losses, we have provided a full valuation allowance, in the U.S. and in foreign tax jurisdictions in which we operate that are in a full tax asset position, against our deferred tax assets. This is more fully described in Note 10—Income Taxes to our consolidated financial statements, included in the Annual Report on Form 10-K. The ability to utilize these losses, any future losses, and any other tax credits or attributes may be restricted or eliminated by changes in our ownership, changes in legislation, and other rules affecting the ability to offset future taxable income with losses from prior periods. Future determinations on the need for a valuation allowance on our net deferred tax assets will be made on an annual basis, and our assessment at December 31, 2014 reflects a continued need for a full valuation allowance.

Stock-based compensation

Accounting guidance requires employee stock-based payments to be accounted for under the fair value method. Under this method, we are required to record compensation cost based on the estimated fair value for stock-based awards granted over the requisite service periods for the individual awards, which generally equals the vesting periods. We use the straight-line amortization method for recognizing stock-based compensation expenses.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards requires the use of highly subjective estimates and assumptions, including the estimated fair value of our common stock. Following our initial public offering, we used the quoted market price of our common stock to establish the fair value of the common stock underlying our stock options. Because there was no public market for our common stock prior to our initial public offering, our board of directors determined the fair value of our common stock with input from management, based on reports of an unrelated third-party valuation specialist.

We estimate the fair value of stock options on the date of grant using the Black-Scholes option-pricing model, and the fair value of option awards with market based vesting conditions on the date of grant using the lattice model with a Monte Carlo simulation. These models further require the use of highly subjective estimates and assumptions, including expected stock price volatility, expected term of an award, risk-free interest rate, and expected dividend yield. As a public company with limited trading history, we consider both the volatility of our stock price and that of our publicly traded peer companies. The expected life assumption is based on the simplified method for estimating expected term as we do not have sufficient stock option exercise experience to support a reasonable estimate of the expected term. The risk-free interest rate is based on the implied yield currently available on U.S. Treasury zero-coupon issues with terms approximately equal to the expected life of the stock option. We use an expected dividend rate of zero as we currently have no history or expectation of paying cash dividends on our capital stock.

Results of Operations

The following table sets forth, for the periods presented, data from our consolidated statements of operations as a percentage of revenue that each line item represents. The period-to-period comparison of financial results is not necessarily indicative of future results. The information contained in the tables below should be read in conjunction with financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

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	Years Ended December 31,					
	2014		2013		2012	
	(% of revenue)					
Consolidated statements of operations data:						
Revenue	100.0	%	100.0	%	100.0	%
Cost of revenue	31.5		32.5		34.6	
Gross profit	68.5		67.5		65.4	
Operating expenses:						
Research and development	19.7		19.5		23.7	
General and administrative	14.5		13.3		11.8	
Sales and marketing	40.7		44.2		50.8	
Restructuring charges	0.6		0.3		1.6	
Total operating expenses	75.5		77.3		87.9	
Loss from operations	(7.0)	)	(9.8)	)	(22.5))
Interest and other (expense) income, net	(0.3))	—)	—)
Loss before income taxes	(7.3)	)	(9.8)	)	(22.5))
Provision for income taxes	(0.3)	)	(0.1))	—)
Net loss	(7.6)	)%	(9.9)	)%	(22.5))%
Comparison of Years Ended December 31, 2014, 2013, and 2012						
Revenue						
	Years Ended December 31,			2013 to 2014	2012 to 2013	
	2014	2013	2012	% Change	% Change	
	(in thousands, except percentage data)					
Revenue	\$122,620	\$107,194	\$84,043	14.4	%	27.5
Revenue increased by \$15.4 million in 2014 and by \$23.2 million in 2013, primarily due to increases in the average selling prices for our SMB and consumer solutions. Revenue from our SMB solutions was approximately \$31.0 million in 2014 compared to \$21.4 million in 2013.						
Cost of revenue, gross profit, and gross margin						
	Years Ended December 31,			2013 to 2014	2012 to 2013	
	2014	2013	2012	% Change	% Change	
	(in thousands, except percentage data)					
Cost of revenue	\$38,567	\$34,881	\$29,060	10.6	%	20.0
Percent of revenue	31.5	%	32.5	%	34.6	%
Components of cost of revenue:						
Personnel-related costs	\$12,614	\$10,361	\$8,666	21.7	%	19.6
Hosting and depreciation costs	21,609	20,555	18,463	5.1	%	11.3
Software, amortization and other	4,344	3,965	1,931	9.6	%	105.3
Total cost of revenue	\$38,567	\$34,881	\$29,060	10.6	%	20.0
Gross profit	\$84,053	\$72,313	\$54,983	16.2	%	31.5
Gross margin	68.5	%	67.5	%	65.4	%

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Our gross margin improvement for 2014 and 2013 was driven by an increasing percentage of our revenues derived from higher margin SMB products and efficiencies realized in our data centers. Cost of revenue increased by \$3.7 million in 2014 and by \$5.8 million in 2013, primarily driven by an increase in personnel-related costs and other costs associated with maintaining our data centers. The increase in cost of revenue in 2014 was comprised primarily of an increase in personnel-related costs of \$2.3 million associated with additional customer support and operations headcount, and an increase in hosting and depreciation costs of \$1.1 million mainly related to an increase in rent and utilities related to additional data center space. The increase in cost of revenue in 2013 was comprised primarily of an increase in hosting costs of \$2.1 million related to rent, utilities, and depreciation of equipment, an increase in personnel-related costs of \$1.7 million associated with additional customer support and operations headcount, and software and amortization costs of \$1.6 million related to investments in our customer support organization to support our growth as well as additional amortization expense related to our Zmanda, Inc. acquisition.

Operating expenses

Research and development

	Years Ended December 31,			2013 to 2014	2012 to 2013	
	2014	2013	2012	% Change	% Change	
	(in thousands, except percentage data)					
Research and development	\$24,132	\$20,919	\$19,925	15.4	% 5.0	%
Percent of revenue	19.7	% 19.5	% 23.7	%		
Components of research and development:						
Personnel-related costs	\$18,556	\$16,275	\$15,974	14.0	% 1.9	%
Third-party outsourcing costs	3,064	1,885	1,270	62.5	% 48.4	%
Hosting, independent contractors and other	2,512	2,759	2,681	(8.9)	)% 2.9	%
Total research and development	\$24,132	\$20,919	\$19,925	15.4	% 5.0	%

Research and development expenses increased by \$3.2 million in 2014, primarily related to an increase of \$2.3 million in personnel-related costs associated with additional research and development headcount and an increase of \$1.2 million in third-party outsourcing costs intended to improve the ease of use and functionality of our existing solutions and the development of new SMB offerings. Research and development expenses increased by \$1.0 million in 2013, primarily driven by higher outsourced development costs.

General and administrative

	Years Ended December 31,			2013 to 2014	2012 to 2013	
	2014	2013	2012	% Change	% Change	
	(in thousands, except percentage data)					
General and administrative	\$17,862	\$14,275	\$9,928	25.1	% 43.8	%
Percent of revenue	14.5	% 13.3	% 11.8	%		
Components of general and administrative:						
Personnel-related costs	\$10,350	\$7,413	\$4,672	39.6	% 58.7	%
Professional fees	4,278	4,365	4,001	(2.0)	)% 9.1	%
Consulting, taxes and other	3,234	2,497	1,255	29.5	% 99.0	%
Total general and administrative	\$17,862	\$14,275	\$9,928	25.1	% 43.8	%

General and administrative expenses increased by \$3.6 million in 2014, primarily related to an increase of \$2.9 million in personnel-related costs associated with additional headcount. The remaining increase in expenses relates to an increase in legal fees and consulting expenses associated with our international expansion efforts. General and administrative expenses increased by \$4.3 million in 2013, primarily related to an increase of \$2.7 million in personnel-related costs and increase of \$0.5 million related to a sales tax accrual for uncollected sales taxes.

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Sales and marketing

	Years Ended December 31,			2013 to 2014	2012 to 2013	
	2014	2013	2012	% Change	% Change	
	(in thousands, except percentage data)					
Sales and marketing	\$49,882	\$47,349	\$42,719	5.3	% 10.8	%
Percent of revenue	40.7	% 44.2	% 50.8	%		
Components of sales and marketing:						
Personnel-related costs	\$13,907	\$8,961	\$6,550	55.2	% 36.8	%
Advertising costs	17,952	25,197	24,019	(28.8)	)% 4.9	%
Costs of credit card transactions and offering free trials	6,245	5,538	5,429	12.8	% 2.0	%
Agency fees, consulting and other	11,778	7,653				