BLACKBAUD INC
Form 10-K
February 20, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year ended December 31, 2018
OR
¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________________ to __________________.

Commission file number: **000-50600**

Blackbaud, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**11-2617163**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

65 Fairchild Street
Charleston, South Carolina 29492
(Address of principal executive offices, including zip code)
(843) 216-6200
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, $0.001 Par Value	**The Nasdaq Stock Market LLC (Nasdaq Global Select Market)**

Securities Registered Pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES þ 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 þ
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES þ NO ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES þ NO ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) 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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on June 30, 2018 (based on the closing sale price of $102.45 on that date) was approximately $4,380,929,403. Common stock held by each officer and director and by each person known to the registrant who owned 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the registrant’s common stock outstanding as ofFebruary 4, 2019 was 48,568,295.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2019 Annual Meeting of Stockholders currently scheduled to be held June 13, 2019 are incorporated by reference into Part III hereof. Such definitive Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the conclusion of the registrant's fiscal year ended December 31, 2018.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including the documents incorporated herein by reference, contains forward-looking statements that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These "forward-looking statements" are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our anticipated growth, the effect of general economic and market conditions, our business strategy and our plan to build and grow our business, our operating results, our ability to successfully integrate acquired businesses and technologies, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the impact of expensing stock-based compensation, the sufficiency of our capital resources, our ability to meet our ongoing debt and obligations as they become due, the adequacy of our data security procedures, and potential litigation involving us, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as “believes,” “seeks,” “expects,” “may,” “might,” “should,” “intends,” “could,” “would,” “targets,” “plans,” “anticipates,” “aims,” “projects,” “estimates,” or any variations of such words and similar expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Accordingly, they should not be viewed as assurances of future performance, and actual results may differ materially and adversely from those expressed in any forward-looking statements.

Important factors that could cause actual results to differ materially from our expectations expressed in forward-looking statements include, but are not limited to, those summarized under “Item 1A. Risk factors” and elsewhere in this report and in our other SEC filings. Forward-looking statements represent our management's beliefs and assumptions only as of the date of this Annual Report on Form 10-K. We undertake no obligation to update or revise any forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in any forward-looking statements, whether as a result of new information, future events or otherwise.

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Blackbaud, Inc.

PART I.

ITEM 1. BUSINESS

Description of Business

We are the world's leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, companies, education institutions, healthcare organizations and individual change agents—we connect and empower organizations to increase their impact through cloud software, services, expertise and data intelligence. Blackbaud brings more than three decades of leadership to this sector: since originally incorporating in New York in 1981 and later reincorporating as a South Carolina corporation in 1991 and as a Delaware corporation in 2004, our tailored portfolio of software and services has grown to support the unique needs of vertical markets, with solutions for fundraising and CRM, marketing, advocacy, peer-to-peer fundraising, corporate social responsibility, school management, ticketing, grantmaking, financial management, payment processing and analytics. Our solutions are designed to meet the needs of virtually all types of organizations in the social good community, from major global institutions to local soup kitchens. At the end of 2018, we had over 45,000 customers located in over 60 countries. We are deeply proud to play a part in our customers' success in their missions to cure diseases, advance education, preserve and share arts and culture, help animals, support those in need and more.

Market Overview

The philanthropic industry is significant, and our addressable market is substantial and growing

Worldwide there are millions of social good organizations including nonprofits, foundations, companies, education institutions and healthcare organizations. Billions of individuals are also active participants in the social good community by donating funds, volunteering their time, advocating for a cause or otherwise engaging with social good organizations.

Our estimated current total addressable market ("TAM") is greater than $10 billion. This includes an expansion into new and near adjacencies in 2018, including our Cloud Solution for Faith Communities, our expanded Cloud Solution for Higher Education, our Integrated Cloud Initiative for Nonprofits in partnership with Microsoft, as well as our acquisition of YourCause Holdings, LLC ("YourCause") on January 2, 2019.

Traditional methods of fundraising and organizational management are often costly and inefficient

Many social good organizations use manual methods or stand-alone software applications not specifically designed for fundraising and organizational management for institutions like theirs. Such methods are often costly and inefficient because of the difficulties in effectively collecting, sharing and using donation-related information. Furthermore, general purpose software applications frequently have limited functionality and do not efficiently integrate multiple databases. Some social good organizations have developed proprietary software, but doing so is expensive, requiring on-site technical personnel for development, implementation and maintenance.

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The nonprofit industry faces particular operational challenges

Nonprofit organizations, education institutions and healthcare organizations must efficiently:

- Solicit funds and build relationships with major donors;
- Garner small cash contributions from numerous contributors;
- Manage and develop complex relationships with large numbers of constituents;
- Advocate for policies and behaviors that advance their cause or institution;
- Communicate their accomplishments and the importance of their mission online and offline;
- Comply with complex accounting, tax and reporting requirements that differ from those for traditional businesses;
- Solicit cash and in-kind contributions from businesses to help raise money or deliver products and services;
- Provide a wide array of programs and services to individual constituents and beneficiaries; and
- Improve the data collection and information sharing capabilities of their employees, volunteers and donors by creating and providing distributed access to centralized databases.

Because of these challenges, we believe nonprofits, healthcare organizations and education institutions can benefit from software applications and services specifically designed to serve their particular needs and workflows to grow revenue, work effectively and accomplish their missions.

Companies, grantmaking institutions and foundations also face unique challenges

Companies, grantmaking institutions and foundations, face their own unique challenges, including the need to:

- Quantify and improve the impact of their grants;
- Cultivate better relationships with grantees;
- Achieve better internal collaboration and alignment with board members, reviewers and other stakeholders;
- Illustrate the impact of their corporate philanthropy efforts to the communities they serve;
- Engage employees in meaningful volunteering, giving and other activities;
- Ensure that their philanthropic efforts align with their business initiatives;
- Manage all of a foundation's activities, including fundraising and accounting;
- Expand the reach of their fundraising efforts; and
- Cultivate new and existing donors.

Strategy

Our objective is to maintain and extend our position as the leading provider of cloud software and services for the global social good community, supporting its missions from fundraising to delivering outcomes. Our key strategies for achieving this objective are to:

Delight our customers

We intend to make our customers' experience with us effective, efficient and satisfying from their initial interest in our solutions and services through their decision to purchase, engage with customer support and utilize solution enhancements. We continue to focus on initiatives aimed at improving the consistency and quality of user experience across our offerings. We also continue to evolve the manner in which we package and sell our offerings to provide high quality and value combined with flexibility to meet the unique needs of our existing and prospective customers. For example, we have increased the number of our cloud solutions sold under a subscription pricing model, which can make it easier for customers to purchase our solutions. In addition, we are continuing to integrate value-adding capabilities such as payment services, analytics and business intelligence into our suite of solutions to better address our customers' needs with comprehensive offerings. We will continue to focus on providing the highest level of solution support, enhancing our existing solutions and developing new solutions and services designed to help our customers be more effective and achieve their missions.

Execute on our Four-Point Growth Strategy

During 2018, we continued to execute our four-point growth strategy targeted to drive an extended period of solution and service innovation, quality enhancement, increased operating efficiency and improved financial performance:

1. *Integrated and Open Solutions in the Cloud*

We will continue to transition our business to predominantly serve customers through a subscription-based cloud delivery model, enabling lower cost of entry, greater scalability and lower total cost of ownership to our customers. We continue to optimize our portfolio of solutions and integrate powerful capabilities — such as built-in data analytics, payment services and tailored user experiences — to bring even greater value and performance to our customers. During 2018, we made several portfolio announcements, ranging from solution integrations to new capabilities for existing solutions to new solution introductions. We introduced our Cloud Solution for Faith Communities, which combines our proven strength in financial management, fundraising, marketing, payments and analytics with our completely new Church Management capabilities. With this move, we now will provide integrated end-to-end cloud capabilities that enable churches to digitally transform their operations through a single connected experience. We also announced our Cloud Solution for Higher Education, introducing a new Education Management portfolio, along with stewardship management and guided fundraising capabilities tailored for higher education. This new cloud solution will enable customers to manage the complete student life cycle, from admissions to alumni engagement, student enrollment, classroom scheduling and a student information system. We also announced the Integrated Cloud Initiative for Nonprofits, a joint investment with Microsoft to accelerate cloud innovation in areas that address critical market needs across the mission life cycle of nonprofits. As part of this initiative, we are jointly developing a solution called Nonprofit Resource Management, which is a breakthrough in helping nonprofits effectively source, track, distribute and measure the impact of their resources across core business processes for managing the distribution of everything from material goods to financial and human capital.

2. *Drive Sales Effectiveness*

We are making investments to increase the effectiveness of our sales organization, with a focus on enabling our expanding sales teams with the talent, processes and tools to accelerate our revenue growth and improve effectiveness. Our sales teams are now managed on a common sales operating model. This model, which is driving increased productivity, includes common procedures, training, key operating metrics, compensation plans and reporting. Our sales account executives now lead with a total-solution selling strategy by vertical, focused on recurring revenue and driving more products per customer, higher ASPs and increased customer retention over the long-term. We believe that attaching training, analytics and payments improves the cloud experience, drives customer outcomes, improves retention and increases customer lifetime value. We continue to innovate and acquire solutions that create greater value for our customers. We spent the second half of 2018 ramping our direct sales hiring resulting in an increase in sales headcount of 19% since the end of 2017. We expect to continue making similar investments during 2019 and beyond. These incremental investments are intended to address the large market opportunity that we see for ourselves and fuel future revenue growth. Also, our partnership with Microsoft is gaining momentum with Microsoft introducing us to new joint-selling opportunities.

3. *Expand TAM into Near Adjacencies with Acquisitions and Product Investments*

We will continue to evaluate compelling opportunities to acquire companies and acquire or build technologies and services. We will be guided by our acquisition criteria for considering attractive assets that expand our TAM, provide entry into new and near adjacencies, accelerate our shift to the cloud, accelerate revenue growth, are accretive to margins and present synergistic opportunities.

In 2018, we announced our Cloud Solution for Faith Communities, our expanded Cloud Solution for Higher Education and the Integrated Cloud Initiative for Nonprofits, demonstrating that we are now in a position to organically build and not just acquire incremental TAM. These solution introductions added approximately $2 billion to our TAM.

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We also acquired Reeher in the second quarter of 2018 to bolster our extensive performance benchmarking capabilities. In addition, our recent acquisition of YourCause, which closed on the first business day in January 2019, added another half-billion dollars to our TAM. Our TAM now stands at over $10 billion.

4. Improve Operating Efficiency

We continue driving towards a more scalable operating model that creates efficiency and consistency in how we execute through infrastructure investments, productivity initiatives, and organizational re-alignments. Our organizational model, which we have evolved over the past few years, is largely complete and allows us to gain efficiency and consistency in how we execute. We have centralized our operations, including marketing, sustained engineering, product management, finance, customer support, customer success and professional services, which allows us to better manage the entire customer experience. We also created an operational excellence function inside of Blackbaud that focuses on maximizing the effectiveness of the business through continuous improvement.

In 2018, we continued executing against a cohesive workplace strategy in an effort to improve operating efficiency and further our organizational objectives, with our geographically diverse workforce. We also furthered our efforts to relocate some of our existing offices to highly modern and more collaborative workspaces with short-term financial commitments. These workspaces are more centrally located for our employees and closer to our customers. Our aim is optimizing our office utilization, improving our geographic sales coverage, and enhancing our employees' daily experience to improve productivity and effectiveness. We have continued this initiative into 2019 and expect to be largely complete by the end of this year.

We have also begun near-shoring certain functions such as customer operations and support on a selective basis to Costa Rica, enabling efficient resource investment to support our growing business.

Attract Top Talent and Actively Engage Employee Base

Our customers' passion is our purpose, and we have incredible customers whose missions make the world a better place for all of us. Driven by this purpose, our employees come to work every day knowing that they can make a real difference with our customers and thus, the world. Collaboration, innovation and high standards are core to our culture and help to enable the great work we do. We strive to hire the best employees and provide a workplace where their talents and potential are realized. Our employees' engagement is a focus of every leader at Blackbaud, and we continually work to understand what matters and to make our workplace better. We believe people with a passion for purpose can have a unique and fulfilling career experience on our team. Our leaders are committed to our employees' personal and career development and continually work to improve the training and tools provided to their teams.

Build our Reputation as an Industry Thought Leader

In our 37 years of experience in the philanthropic market, we have gained significant insight into the overall market and industry segments in which we operate. We produce a wide range of thought leadership materials, including blogs, monthly indices and white papers, which provide insights and guidance to the social good community. We also participate in a number of industry forums, where we exchange views and engage with industry and government leaders. Our annual user conference, ***bbcon***™, is used in part as a forum to offer thought leadership to our customers, as are other market specific user conferences such as our annual K-12 conference. We intend to expand these activities and further build our reputation as a thought leader within the industry. Additionally, the Blackbaud Institute for Philanthropic Impact brings together the best minds in philanthropy to develop and share leading-edge research and insight that accelerates the impact of the social good community. The research and reports the Blackbaud Institute produces serve to strengthen the social good community as a whole.

Solutions and Services

We offer a full spectrum of cloud and on-premises solutions, as well as a resource network that empowers and connects organizations of all sizes. The Blackbaud portfolio is delivered primarily through cloud solutions tailored to the unique needs of vertical markets, offering fundraising and relationship management, marketing and engagement, financial management, grant and award management, organizational and program management (such as education and church management and ticketing), social responsibility, payment services and analytics. We offer the social good community comprehensive cloud solutions to advance their missions, backed by our analytic services, which deliver insights powered

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by the world's most robust philanthropic data set. Our solutions can be combined with a range of consulting, training and professional services, maintenance and technical support, as well as payment processing, analytic and business intelligence services. In addition, we offer solutions that span the full spectrum of giving activities, including corporate social responsibility ("CSR") programs, grant management, employee involvement, foundation management and other philanthropic activities.

Our specific solutions and services include:

Fundraising and Relationship Management

Blackbaud Raiser's Edge NXT® is our flagship smart cloud fundraising and relationship management solution. Blackbaud Raiser's Edge NXT is the first and only cloud fundraising and relationship management solution that is all-inclusive, fully integrated with data, analytics, marketing tools, payment processing and tailored user-specific experiences. Blackbaud Raiser's Edge NXT is, we believe, the most advanced technology available to nonprofits seeking to operate more efficiently and raise more support for their missions.

Blackbaud CRM™ is a comprehensive, customizable fundraising and relationship management solution. It is our lead offering for enterprise-level organizations seeking a powerful, yet adaptable solution for fundraising, marketing, and program management across the engagement lifecycle, specializing in supporting sophisticated major giving, membership and high-volume direct marketing programs. Blackbaud CRM helps organizations build deeper and more personalized relationships with constituents, build their brand through online engagement and multichannel communication tools, and more effectively fundraise, leveraging campaign management, business intelligence and analytics. Blackbaud CRM can be sold as an integrated solution with our enterprise online solutions to enable multi-channel marketing, online engagement and event fundraising.

Blackbaud Luminate CRM™ is our Salesforce-based CRM offering for nonprofits and is sold as a single integrated solution with Blackbaud Luminate Online®. Blackbaud Luminate CRM is built on the Salesforce.com cloud computing application platform and offers nonprofits an extensible suite via the Salesforce App Exchange for consolidating information and business processes into one system. The core components of Blackbaud Luminate CRM are campaign management, constituent relations, business intelligence and analytics. When combined with Blackbaud Luminate Online, it provides best-in-class functionality to help nonprofits with online fundraising, peer-to-peer event fundraising, payment processing, email marketing, advocacy and website management.

Blackbaud eTapestry® is a simple, cloud fundraising and donor management solution built specifically for smaller, developing nonprofits in need of a cloud solution to support basic fundraising needs. It offers nonprofit organizations a cost-effective way to manage donors, process gifts, create reports, accept online donations and communicate with constituents. This technology provides a system that is simple to maintain, efficient to operate and is intuitively easy to learn without extensive training.

Blackbaud TeamRaiser® is the industry’s most comprehensive cloud solution designed specifically for event fundraising. Powering thousands of events each year, Blackbaud TeamRaiser allows nonprofits’ supporters to create personal or team fundraising web pages and send email donation appeals in support of events such as walks, runs and rides.

everydayhero® is an innovative, cloud crowdfundraising solution designed to meet the peer-to-peer fundraising needs of nonprofits' supporters. It is a leading donor acquisition tool, and helps nonprofits connect with a younger, more online-focused generation of donors, a first step in helping nonprofits develop long-term relationships with their supporters. Founded in

Australia, where it is a market leader, everydayhero is now sold throughout Europe and the U.S. Its integrations with fitness applications such as Strava and MapMyFitness continue to enhance the fundraising landscape by providing millions across the globe the chance to easily integrate fitness and philanthropy.

Blackbaud Peer-to-Peer Fundraising™, powered by JustGiving™ is one of the world's leading social platforms for giving. Blackbaud Peer-to-Peer Fundraising™, powered by JustGiving™ develops world-class technology and innovative tools to connect people with the causes they care about. By making giving more simple, social and rewarding, JustGiving helps all causes, charities and people in need to reach more people and raise more money.

Blackbaud Guided Fundraising™ and *Blackbaud Volunteer Network Fundraising™* can work together or independently to help higher education institutions meet their advancement targets and development campaign goals. Blackbaud Guided Fundraising is used by institutions seeking to manage all the details behind the sophisticated, person-to-person solicitation strategies that drive fundraising results. Blackbaud Volunteer Network Fundraising helps

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institutions manage volunteer fundraising campaigns with tools for project management, communication, and reporting.

Marketing and Engagement

Blackbaud Luminate Online®, delivered in the cloud, helps our customers better understand their online supporters, make the right ask at the right time, and raise money online. It includes tools to build online fundraising campaigns as part of an organization's existing website or as a stand-alone fundraising site. Donation forms, gift processing, and tools for communicating through web pages and email give our customers the essentials for building sustainable donor relationships. Customers can also purchase additional modules including Blackbaud Luminate Advocacy,™ which combines online marketing tools and legislative data to mobilize supporters and influence policy-makers.

Blackbaud Online Express™ is a simple, cloud fundraising and marketing tool designed for smaller nonprofit organizations using Raiser’s Edge® and Blackbaud Raiser's Edge NXT. It provides nonprofits with easy-to-use, fully integrated features and functionality such as email marketing, donation forms, event registrations and dashboard metrics.

Blackbaud NetCommunity™ is an online marketing and communications tool that enables organizations that utilize Raiser's Edge software to build interactive websites and manage email marketing campaigns. With Blackbaud NetCommunity, organizations can, among other things, establish online communities for social networking among constituents and also provide a platform for online giving, membership purchases and event registration. Because Blackbaud NetCommunity's deep integration requires a Raiser's Edge database to operate, it can only be sold with Raiser's Edge or to existing Raiser's Edge customers.

Blackbaud Attentive.ly™ is a cloud portal enriched with data that allows marketers to drive engagement with their organization or institution by providing social media insights. It can be used as a stand-alone application or integrated into Blackbaud’s fundraising and marketing applications, helping marketers reach new audiences and shape meaningful conversations online.

Blackbaud School Website System™ is a content management system that gives schools the flexibility to build and edit webpages, with easy access to content types including photos, videos, downloads, text and more. It allows users to share material and contribute content across an entire school community.

Financial Management

Blackbaud Financial Edge NXT® is the first-of-its-kind cloud accounting solution for nonprofits that is intuitive, fully integrated, and built the way nonprofits need it on our modern Blackbaud SKY cloud architecture. Blackbaud Financial Edge NXT is advanced technology with powerful reporting tools to help accounting teams drive transparency, stewardship, and compliance while enabling them to seamlessly manage transactions and eliminate manual processes. It seamlessly integrates with Blackbaud Raiser's Edge NXT to simplify gift entry processing and relates information from both systems in an informative manner to eliminate redundant tasks and manual processes. Blackbaud Financial Edge NXT provides nonprofit organizations with the means to help manage fiscal and fiduciary responsibility, enabling them to be more accountable to their constituents.

Blackbaud Smart Tuition™ benefits schools by giving administrators better access to financial data and payment services, and by giving parents more ways to remit tuition payments. The solution helps ease the burden for administrative staff by offering invoicing, payment processing, customer service, enhanced communication with parents and later payer follow-up services.

Blackbaud Smart Aid™ offers schools the ability to accept online, customized applications for financial aid and to make better financial aid decisions with a proprietary Hobbies, Interest and Lifestyles ("HIL") profile. The HIL profile provides in-depth information on an applicant, delivering to the school a way to make more informed decisions on how they distribute financial aid awards.

Grant and Award Management

Blackbaud Grantmaking™ is a cloud solution built with core functions that provide comprehensive grant making capabilities, but with many additional capabilities and features, such as visual dashboards. It has a modern user interface, is user friendly, and can be highly personalized.

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Blackbaud Award Management™ is a comprehensive, integrated scholarship management platform for higher education and K-12 institutions and foundations, allowing students to apply for all awards using one intuitive and streamlined application process and eliminating many time consuming administrative tasks. This leads to improved awarding, reporting, compliance, communication and stewardship.
FIMS™ is a fully-integrated foundation management system that helps community foundations, faith communities, education institutions and scholarship programs manage grants, finances and donors in one centralized, comprehensive system. It features an open, customizable framework that helps manage everything from donors, gifts and investments to grants, grantees, funds and financials.
Blackbaud Outcomes™ empowers funders and nonprofits to collaborate around their intended program outcomes and work together to achieve impact. The cloud software helps users define and measure their outcomes, allowing them to track the effectiveness of their programs, make informed decisions, better understand the impact of their social investments, and tell an impact story using ROI-focused results and a common outcomes measurement language.
Organizational and Program Management
Blackbaud Student Information System™ makes it easy for schools to manage schedules, transcripts and GPAs. A new Student Information System that works directly with Blackbaud Learning Management System™, Blackbaud Student Information System simplifies the process of sharing student data and academic records securely.
Blackbaud Learning Management System™ is a learning management system that makes it easy to manage, connect, and share information with students, parents, and an entire school community. Developed with direct input from our customers, Blackbaud Learning Management System gives teachers the tools to meet the demands of a modern private school.
Blackbaud Enrollment Management System™ is an enrollment management system that simplifies a school’s admissions process. Blackbaud Enrollment Management System helps admissions teams and prospective families manage and track their progress, from inquiry and application through acceptance and enrollment.
Blackbaud Altru® is a cloud solution that helps arts and cultural organizations consolidate admissions, membership, fundraising, merchandise, marketing and more, giving users a comprehensive view of their supporters. By helping general admissions arts and cultural organizations gain a clear, 360-degree view of their organization, it enables them to operate more efficiently, engage and cultivate patrons and supporters, streamline external and internal communication efforts, and reduce IT costs. Blackbaud Altru contains tools for constituent and membership management, program sales, retail sales and ticketing, volunteer management, and events management. It also has sophisticated reporting functionality and tools to manage marketing, communications and fundraising.
Blackbaud Church Management® is a comprehensive, end-to-end cloud solution to manage your church operations, relationships with congregants, and essential financial management needs. With Blackbaud Church Management, churches can track gifts and tithing, assimilate new members, directly communicate with congregations through multiple channels, enable members to make online and mobile contributions, manage small groups and volunteers, implement secure child check-in, conduct background checks, provide bulk tax statements, manage facilities, and more. Churches can also add other Blackbaud capabilities from the new Cloud Solution for Faith Communities as their needs scale all through one integrated

experience.

Corporate Social Responsibility

Blackbaud Employee Giving™ and Blackbaud Employee Volunteering™ are integrated social responsibility solutions that help companies and other organizations mobilize the collective power of their employees to make a positive impact on their people, their company, and the world.

YourCause™ is a cloud platform for employee giving, volunteering, and communication used by Fortune 500 companies and small businesses to support corporate philanthropy by building meaningful connections between corporations, employees, and nonprofits. After implementing YourCause solutions, customers show significant growth in volunteers, donations, engagement and more. These reported successes demonstrate a larger trend: overall ability to attract employees and customers alike by strengthening a company's reputation. Eight million people can currently engage with YourCause's solution, which processes more than $245,000 in donations every business hour and has coordinated, tracked and rewarded more than 30 million volunteer hours for its customers.

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Analytics

Our analytics offerings provide comprehensive solutions for donor acquisition, prospect research, data enrichment and performance management, enabling nonprofits to define effective campaign strategies and maximize fundraising results. These services either integrate with or are already integrated into our software solutions to give our customers a comprehensive view of their supporters and the market and provide information essential to making well-informed operating decisions.

Blackbaud’s SKY Intelligence® is a unique, comprehensive approach through which we combine artificial intelligence, analytics, big data, and expertise in cloud-based services and other channels. This powerful approach enables social good organizations to transform data into insights.

Our analytics offerings include subscription solutions and services within the following areas:

Donor Acquisition - Our donor acquisition solutions leverage unique data assets to create acquisition mailing lists and predictive models that identify donor populations that meet the affinity, value and response criteria of our nonprofit customers. Nonprofit organizations use our prospect lists to solicit gifts and other support.

Prospect Research - Our prospect research solutions include: custom data modeling that delivers critical information on a prospect's likelihood to make a gift to an organization; wealth screenings that deliver detailed wealth information and giving capacity data on prospects; and web-based prospect management software that combines public data with donor information from a nonprofit's database to build a complete view of prospects for targeting and securing gifts.

Data Enrichment - Our data enrichment solutions enhance the quality of the data in our customers' databases. These solutions include: identifying outdated address files in the database and making corrections based on United States Postal Service data, as well as appending data by using known fields in an organization's constituent records to search and identify key demographic and contact information.

Benchmarking and Performance Management - Our performance management solutions create relevant and insightful reports that benchmark performance and illustrate key industry trends based on performance attributes provided by our nonprofit customers. Nonprofit organizations use our performance and industry analysis reports to assess marketing and operational effectiveness, and to influence operational planning.

Payment Services

Our solutions provide our customers payment processing capabilities that enable their donors to make donations and purchase goods and services using numerous payment options, including credit card and automated clearing house (“ACH”) checking transactions, through secure online transactions.

Blackbaud Merchant Services™ is a value-added service integrated with our solutions that makes credit card processing simple and secure. Customers are charged one rate for credit card transactions, making Blackbaud Merchant Services a competitive option. The service also provides customers with a payment card industry (“PCI”) compliant process and streamlined bank reconciliation. We also provide our K-12 private school customers with student tuition payment processing services.

Blackbaud Purchase Cards™ provide an efficient and convenient alternative to traditional procurement methods and paper-based payables processes such as checks, purchase orders and invoices for travel and operational purchases. Organizations can also set spend controls for individual cardholders, track business expenses across the organization and ensure that policies are being enforced—all managed online and integrated with Blackbaud Financial Edge NXT.

Customer Success

Our Customer Success organization is responsible for managing the business and technical relationship with our customers. Their mission is to develop and foster relationships within all levels of the customer organization to build more demonstrated value in our solutions and services. Customer Success Managers ("CSMs") work to proactively communicate to drive overall satisfaction and retention of our customer's business. At every point of communication, they work to collect and analyze actionable information that can be used to make their experience positive and consistent. Their goal is to partner with customers to ensure that they are fully engaged and have an advocate within Blackbaud who works to meet their needs.

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CSMs bring industry knowledge and expertise to the customer relationship and strive to help our customers achieve positive growth and outcomes.

Customer Support & Maintenance

Most customers that purchase our solutions also enroll in one of our support and maintenance programs. For many of our cloud-based subscription solutions, customer support is automatically included as part of the solution. Customers enrolled in the programs enjoy fast, reliable customer support, receive regular software updates, stay up-to-date with regular communication and have unlimited, around-the-clock access to support resources, including our extensive knowledgebase and forums. Customers who enroll in upgraded support and maintenance plans receive enhanced benefits such as call support priority and dedicated support resources.

Professional and Managed Services

Our expert consultants provide data conversion, implementation and customization services for each of our software solutions. These services include:

- System implementation;
- Data conversion, business process analysis and application customization;
- Database merging and enrichment, and secure credit card transaction processing;
- Database production activities; and
- Website design services.

In addition, we apply our industry knowledge and experience, combined with expert knowledge of our solutions, to evaluate an organization's needs and consult on how to improve a business process.

Training

We provide a variety of onsite, instructor-led online and on-demand training services to our customers relating to the use of our solutions and application of best practices. Our instructors have extensive training in the use of our solutions and present course material that is designed to include hands-on lab exercises, as well as course materials with examples and problems to solve.

Customers

At the end of 2018, we had over 45,000 customers including nonprofits, foundations, companies, education institutions, healthcare organizations and other charitable giving entities. Our largest single customer accounted for less than 1% of our 2018 consolidated revenue.

Sales and Marketing

Most of our solutions and related services are sold through our direct sales force. Our direct sales force is complemented by a team of business development representatives responsible for sales lead generation and qualification. These sales and marketing professionals are primarily located throughout the United States, the United Kingdom, Canada and Australia. As of December 31, 2018, we had 518 direct sales employees. We plan to continue expanding our global direct sales force to meet our current market coverage needs.

We conduct marketing programs to create brand recognition and market awareness for our solutions and services. Our marketing efforts include participation at tradeshows, technical conferences and technology seminars, publication of technical and educational articles in industry journals and preparation of competitive analyses. Our customers and strategic partners provide references and recommendations that we often feature in our advertising and promotional activities.

We believe relationships with third parties can enhance our sales and marketing efforts. We have and will continue to establish additional relationships with companies that provide services to the philanthropic industry, such as consultants, educators, publishers, financial service providers, complementary technology providers and data providers. These companies promote or complement our solutions and provide us access to new customers.

Corporate Philanthropy and Volunteerism

Blackbaud operates under a fundamental belief that the world would be better if good took over. The company is an active participant in the ecosystem of good, working to drive positive change both through what we do as a business and how we serve individually. We offer an array of philanthropy programs aimed at engaging our employees as agents of good, including matching gifts, competitive grants that honor excellent examples of volunteerism, employee-led grants committees, skills-based volunteerism initiatives, as well as science, technology, engineering and mathematics focused community programs. Blackbaud attracts people who are committed to service, with 87% saying our focus on nonprofits was a driver in their decision to join the company, 84% actively serving as volunteers and 23% serving on a nonprofit board or committee.

Competition

The market for software and related services in the philanthropic industry is competitive and highly fragmented. For certain areas of the market, entry barriers are low, as general tools for small businesses can usually be configured to manage the most basic marketing, contact management, and accounting needs of social good organizations. In parallel, as software development evolves from a highly-complex tradecraft with nuanced understanding of architectural patterns and discrete languages, to click-to-code and drag-and-drop development with natively cloud-based infrastructure, it becomes easier for competitors to quickly spin up basic applications with embedded security and functionality. However, once basic needs are met, programs unique to social good organizations like fundraising, gift and grant management, and peer-to-peer activism require highly specialized tools to configure and transform general business software to match the complexities of the industry. These specialized applications have a higher barrier of entry as they require industry insight to accurately articulate the business workflow that generates the requirements that are translated into code for software products. Moreover, because social good organizations rely heavily on relationships with and among their supporters, integration of systems drives value beyond mere efficiency. Hence, we believe our insight, the full spectrum of our current solutions and our ability to deliver on future solutions makes us a strong competitor. We expect to continue to see new entrants as focus on social investment solutions increases to satisfy Millennials and Gen Z donors, the barriers of entry continue to decline with natively cloud-based solutions, and social good organizations rely intrinsically on technology to manage emerging revenue channels and increasingly complex operations.

Our competition falls into four primary categories: (1) niche products that are tailored to specialized needs; (2) vertical-specific solutions; (3) general business software that can be configured to manage some nonprofit-specific processes; and (4) consumer-oriented fundraising platforms.

Niche products are usually developed as a solution for a single problem at an organization and are adopted by similar organizations to solve a specialized need. These are typically offered by vendors who may have deep industry expertise but may not have the resources to expand beyond a specialized area. We believe we compete against these solutions by offering a set of integrated solutions rather than a single point solution, which we believe improves the overall customer experience. In addition, our open platform allows integration to specialized applications so the opportunity for disruption from these competitors is minimized.

Vertical-specific solutions are offered by competitors seeking to meet the enterprise-wide needs of a specific sub-segment of social good community. Typically, these solutions are offered by vendors who may offer either a point solution or integrated suite of products used by a vertical. We believe we compete successfully against these competitors through a combination of our integrated suite of offerings within verticals where we compete, offering solutions with market leading robustness as well as the scale, reach, and reputation of our organization.

General business software vendors such as Salesforce.com and Oracle, compete with us in certain areas of our business. While there is a growing trend toward social investment that is prompting philanthropic solutions for these general business vendors, most do not have complete nonprofit specific focus and, therefore, do not offer or intend to offer nonprofit-specific versions for outside sales. However, there is a subset of general business software competitors who have introduced nonprofit-specific versions of their products. These products generally do not satisfy the needs of nonprofits from end-to-end as they were not designed to support the specific needs of nonprofits during the original architecture, design, and requirements elicitation phases; therefore, we believe that because these products were not originally designed for nonprofits, they are not yet capable of meeting market needs without significant customization. The significant customization required to transform general business products into nonprofit solutions often requires the use of consultants to guide the implementation, without which, leave the adoption of general business software limited to very basic operations and simple needs. We believe our solutions compete successfully against general business software as a nonprofit's needs grow more complex. As a result, we believe we can compete successfully to meet nonprofit-specific requirements, often integrating with general business platforms used for their more generalized operations.

Consumer-oriented fundraising platforms such as GoFundMe, Virgin Money Giving, and Facebook compete with our business where consumers raise funds directly. To drive adoption of their platforms, these vendors rely on a combination of direct-to-consumer marketing, marketing to nonprofits who in turn market to their supporters, and marketing to intermediate entities such as an event sponsor who will market to participants. We believe we compete well in this market through a combination of positive brand recognition among all three of these groups and the strength of our consumer-oriented tools relative to those of the competition.

Less frequently, we compete with providers of traditional, non-automated fundraising service providers, including parties providing services in support of traditional direct mail or email campaigns, special events fundraising, peer to peer, telemarketing and personal solicitations. We believe we compete successfully against these traditional fundraising service providers, primarily because our solutions and services are more automated, more robust, more tailored to the needs of nonprofit organization and more efficient.

Technology and Architecture

Blackbaud SKY provides the foundation for Blackbaud's next generation solutions such as Raiser's Edge NXT, enabling highly available and easy-to-use cloud capabilities that integrate seamlessly and offering best-in-class infrastructure, integrated shared services, and modern, effective, purpose-built solutions. The platform's service-oriented architecture organizes application features into independently deployable services and then leverages these self-contained services as integrated capabilities across our solution portfolio. This enables rapid innovation with high quality and high availability and lets Blackbaud evolve services over time at asymmetric paces as tech trends and tools emerge. Blackbaud SKY prioritizes customer value and speed of delivery. It enables rapid releases, scalable and high-quality services, and speedy time to market. Blackbaud SKY also provides a toolset for customers, partners, and developers to create and deploy self-contained services within the Blackbaud SKY ecosystem. SKY API enables developers to augment Blackbaud solutions with industry-standard REST APIs, standards-based authentication protocols, and a best-in-class developer experience. SKY UX allows developers to create applications with the same consistent, cohesive user interface as Blackbaud's native solutions using an open source framework that implements Blackbaud design patterns and provides guidelines and tooling for the entire application lifecycle.

The development strategy for all Blackbaud solutions emphasizes flexibility, adaptability and scalability.

- *Flexible:* Customers can extend our component-based architecture to accommodate changing demands without modifying source code.
- *Adaptable:* The architecture of our applications allows us to easily add functionality or integrate with third-party applications to adapt to customer needs and market demands.
-

Scalable: Scalable architecture and the performance, capacity and load balancing of our customers' industry-standard web servers and databases ensure that applications can scale to meet the needs of large organizations.

Intellectual Property and Other Proprietary Rights

To protect our intellectual property, we rely on a combination of patent, trademark, copyright and trade secret laws in various jurisdictions, as well as employee and third-party nondisclosure agreements and confidentiality procedures. We maintain many trademarks, including, but not limited to “Blackbaud,” “Raiser's Edge NXT” and “Luminate.” We currently have three active patents on our technology and have two pending patent applications.

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Employees
As of December 31, 2018, we had 3,353 employees, none of whom are represented by unions or are covered by collective bargaining agreements. We are not involved in any material disputes with any of our employees, and we believe that relations with our employees are satisfactory.

Seasonality
For a discussion of seasonal variations in our business, see "Management's Discussion and Analysis of Financial Conditions and Results of Operations — Seasonality" in Item 7 in this report.

Working Capital
For a discussion of our working capital practices, see "Management's Discussion and Analysis of Financial Conditions and Results of Operations — Liquidity and Capital Resources" in Item 7 in this report.

Available Information
Our website address is www.blackbaud.com. We make available, free of charge through our website, 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 pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC, but other information on our website is not incorporated into this report. The SEC maintains an Internet site that contains these reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

Executive Officers of the Registrant
The following table sets forth information concerning our executive officers as of February 15, 2019:

Michael P. Gianoni	58	President and Chief Executive Officer
Anthony W. Boor	56	Executive Vice President and Chief Financial Officer
Kevin W. Mooney	60	Executive Vice President and President, General Markets Group
Kevin P. Gregoire	51	Executive Vice President and President, Enterprise Markets Group
Brian E. Boruff	59	Executive Vice President, Partner Ecosystem and Global Alliances
Jon W. Olson	55	Senior Vice President and General Counsel

Michael P. Gianoni joined us as President and Chief Executive Officer in January 2014. Prior to joining us, he served as Executive Vice President and Group President, Financial Institutions at Fiserv, Inc., a global technology provider serving the financial services industry, from January 2010 to December 2013. He joined Fiserv as President of its Investment Services division in December 2007. Mr. Gianoni was Executive Vice President and General Manager of CheckFree Investment Services, which provided investment management solutions to financial services organizations, from June 2006 until December 2007 when CheckFree was acquired by Fiserv. From May 1994 to November 2005, he served as Senior Vice President of DST Systems Inc., a global provider of technology-based service solutions. Mr. Gianoni is a member of the Board of Directors of Teradata Corporation, a publicly traded global big data analytics and marketing applications company. Mr. Gianoni has served on several nonprofit boards across several segments, including relief organizations, hospitals and higher education. He currently is a board member of the International African American Museum and on the President's advisory council board at Clemson University. He holds an AS in electrical engineering from Waterbury State Technical College, a BS with a business concentration from Charter Oak State College, and a MBA and an honorary Doctorate from the University of New Haven.

Anthony W. Boor joined us as Executive Vice President and Chief Financial Officer in November 2011 and served as our interim President and Chief Executive Officer from August 2013 to January 2014. Prior to joining us, he served as an executive with Brightpoint, Inc., a global provider of device lifecycle services to the wireless industry, beginning in 1999,

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most recently as its Executive Vice President, Chief Financial Officer and Treasurer. He also served as the interim President of Europe, Middle East and Africa during Brightpoint's significant restructuring of that region. Mr. Boor served as Director of Business Operations for Brightpoint North America from August 1998 to July 1999. Prior to joining Brightpoint, Mr. Boor was employed in various financial positions with Macmillan Computer Publishing, Inc., a Viacom owned book publishing company specializing in computer hardware and software related topics, Day Dream Publishing, Inc., a publishing company specializing in calendars, posters and time management materials, Ernst & Young LLP, an accounting firm, Expo New Mexico, a state-owned fair and expo grounds and live pari-mutual horse racing venue, KPMG LLP, an accounting firm, and Ernst & Whinney LLP, an accounting firm. He holds a BS in Accounting from New Mexico State University.

Kevin W. Mooney has served as our Executive Vice President and President, General Markets Group since January 2010. He joined us in July 2008 as our Chief Commercial Officer. Before joining Blackbaud, Mr. Mooney was a senior executive at Travelport GDS from August 2007 to May 2008. As Chief Commercial Officer of Travelport GDS, one of the world's largest providers of information services and transaction processing to the travel industry, Mr. Mooney was responsible for global sales, marketing, training, service and support activities. Prior to that he was Chief Financial Officer for Worldspan from March 2005 until it was acquired by Travelport in August 2007. Mr. Mooney has also held key executive positions in the telecommunications industry and he served as a member of the Board of Directors of Level 3 Communications, Inc., a publicly traded global managed network services company, from October 2014 to November 2017. He holds a BS in Finance from Seton Hall University, and a MBA in Finance from Georgia State University.

Kevin P. Gregoire joined us as Executive Vice President and President, Enterprise Markets Group in April 2018. Prior to joining us, Mr. Gregoire was Group President of the Financial Institutions Group at Fiserv, a global technology provider serving the financial services industry, from March 2014 until February 2018. He joined Fiserv in December 2002 and served in other key leadership roles including Division President and Chief Operating Officer, Card Services, and Senior Vice President of Product and Network Strategy. Mr. Gregoire is also a veteran of the United States Army, where he served as Lieutenant in the Corps of Engineers and was awarded three Army Commendation Medals. He holds a BS from the United States Military Academy at West Point, and a MBA from the F.W. Olin School of Business at Babson College.

Brian E. Boruff has served as our Executive Vice President, Partner Ecosystem and Global Alliances since April 2018. He joined us as our Executive Vice President and President, Enterprise Markets Group in May 2015. Prior to joining us, Mr. Boruff was the Global Vice President of Products, Platforms and Solutions at Infosys, a global provider of consulting technology and next-generation services, from June 2013 until April 2015. From May 2011 until June 2013 he was a Managing Director at Accenture, a global management consulting and technology services company. From January 2009 until May 2011, Mr. Boruff was the Global Vice President of Cloud Computing and Emerging Technologies at CSC, a global provider of information technology services and solutions. His tenure at Microsoft spanned 15 years from 1992 to 2009 where he held many different leadership roles in Atlanta, Redmond, Philadelphia, Paris France and Washington D.C. Prior to Microsoft, Mr. Boruff spent nine years at Apple and started his career in March 1982 at Hewlett-Packard. He holds a BA in Computer Science and Biochemistry from the University of Tennessee.

Jon W. Olson joined us as Senior Vice President and General Counsel in September 2008. Mr. Olson is responsible for Blackbaud's legal and real estate activities. Prior to joining us, he was an attorney with Alcatel-Lucent USA, the U.S. subsidiary of France-based Alcatel-Lucent (now owned by Nokia Corporation) that designs, develops, and builds wireline, wireless, and converged communications networks, from July 1997 to September 2008. Prior to joining Alcatel-Lucent, Mr. Olson was employed in legal positions with MCI, Inc., a global business and residential communications company, from September 1996 to July 1997, and Unisys Corporation, a global information technology company, from July 1992 to September 1996. Mr. Olson is a member of the MUSC (Medical University of South Carolina) Hollings Cancer Center Citizens Advisory Council and is on the board of the Charleston Symphony and Charleston Jazz. He holds a BS from Georgetown University, a JD from Dickinson School of Law and a MBA from Seton Hall University.

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ITEM 1A. RISK FACTORS

Our business operations face a number of risks. These risks should be read and considered with other information provided in this report.

Our failure to compete successfully could cause our revenue or market share to decline.

Our market is highly competitive and rapidly evolving and there are limited barriers to entry for many segments of this market.

The companies we compete with and other potential competitors may have greater financial, technical and marketing resources and generate greater revenue and better name recognition than we do. Also, a large diversified software enterprise could decide to enter the market directly, including through acquisitions. Competitive pressures can adversely impact our business by limiting the prices we can charge our customers and making the adoption and renewal of our solutions more difficult.

Our competitors might also establish or strengthen cooperative relationships with resellers and third-party consulting firms or other parties with whom we have had relationships, thereby limiting our ability to promote our solutions. These competitive pressures could cause our revenue and market share to decline.

Because a significant portion of our revenue is recognized over time on a ratable basis over the contract term, downturns in sales may not be immediately reflected in our revenue.

We generally recognize our subscription and maintenance revenue ratably over time over the contract term. Our subscription arrangements are generally for a term of three years at contract inception with one to three-year renewals thereafter. Most of our maintenance arrangements are for a one-year term. As a result, much of the revenue we report in each quarter is attributable to arrangements entered into during previous quarters. Consequently, a decline in sales to new customers, renewals by existing customers or market acceptance of our solutions in any one quarter will not necessarily be fully reflected in the revenues in that quarter and could negatively affect our revenues and profitability in future quarters.

If our customers do not renew their subscriptions for our solutions or annual maintenance and support arrangements or if they do not renew them on terms that are favorable to us, our business might suffer.

Our subscription arrangements are generally for a term of three years at contract inception with one to three-year renewals thereafter. Most of our maintenance arrangements are for a one-year term. As the end of the contract term approaches, we seek the renewal of the agreement with the customer. Historically, subscription and maintenance renewals have represented a significant portion of our total revenue. Because of this characteristic of our business, if our customers choose not to renew their subscriptions or maintenance and support arrangements with us on beneficial terms or at all, our business, operating results and financial condition could be harmed. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our solutions and services and their ability to continue their operations and spending levels.

More rapid than expected success in implementing our strategic shift from a license-based and one-time services business model to a cloud-based subscription business model could negatively impact our total revenue growth and financial performance.

We continue to intentionally shift our focus towards selling cloud-based subscription solutions, which generally require less implementation and customization services. Also, our cloud-based solution contracts now frequently include subscription-based professional, analytic and training services. This strategic shift to migrate our existing customers and sell new customers our cloud-based subscription solutions results in a decrease in our one-time services contracts and revenue. Although our business model seeks to anticipate the rate of migration and resulting negative impact on our total revenue growth, more rapid than expected success in implementing this strategic shift could negatively impact our total revenue growth and financial performance.

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Defects, delays or interruptions in our cloud-based solutions and hosting services could diminish demand for these services and subject us to substantial liability.

We currently utilize data center hosting facilities to provide cloud-based solutions to most of our subscription customers and hosting services to our on-premise license customers. Any damage to, or failure of, these data center systems generally could result in interruptions in service to our customers, notwithstanding any business continuity or disaster recovery agreements that may currently be in place at these facilities. Because our cloud-based solutions and hosting service offerings are complex, and we have incorporated a variety of new computer hardware and software systems at our data centers, our services might have errors or defects that users identify after they begin using our services. This could result in unanticipated downtime for our customers and harm to our reputation and business results. Internet-based services sometimes contain undetected errors when first introduced or when new versions or enhancements are released. We have from time to time found defects in our web-based services and new errors might again be detected in the future. In addition, our customers might use our Internet-based offerings in unanticipated ways that cause a disruption in service for other customers attempting to access their data.

Because our customers use these services for important aspects of their businesses, any defects, delays or disruptions in service or other performance problems with our services could hurt our reputation and damage our customers' businesses. If that occurs, customers could elect to cancel their service, delay or withhold payment to us, not purchase from us in the future or make claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or the expense and risk of litigation. Any of these could harm our business and reputation.

Material defects or errors in the software we use to deliver our services could harm our reputation, result in significant costs to us and impair our ability to sell our services.

The software applications underlying our services 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 in our software, and new errors in our existing software may be detected in the future.

After the release of our software, defects or errors may also be identified from time to time by our internal team and our customers. The costs incurred in correcting any material defects or errors in our software may be substantial and could harm our operating results. Furthermore, our customers may use our software together with solutions from other companies. As a result, when problems occur, it might be difficult to identify the source of the problem. Even when our software does not cause these problems, the existence of these errors might cause us to incur significant costs, divert the attention of our technical personnel from our solution development efforts, impact our reputation and cause significant customer relations problems.

Our failure to obtain licenses for third-party technologies could harm our business.

We expect to continue licensing technologies from third parties, including applications used in our research and development activities, technologies which are integrated into our solutions and solutions that we resell. We believe that the loss of any third-party technologies currently integrated into our solutions could have a material adverse effect on our business. Our inability in the future to obtain any third-party licenses on commercially reasonable terms, or at all, could delay future solution development until equivalent technology can be identified, licensed or developed and integrated. This inability in turn could harm our business and operating results. Our use of third-party technologies exposes us to increased risks including, but not limited to, risks associated with the integration of new technology into our solutions, the diversion of our resources from development of our own proprietary technology and our inability to generate revenue from licensed technology sufficient to offset associated acquisition and maintenance costs.

The market for software and services for the social good community might not grow and the organizations in that community might not continue to adopt our solutions and services.

Many organizations in the social good community, including nonprofits, foundations, companies, education institutions and healthcare organizations, have not traditionally used integrated and comprehensive software and services for their specific needs. We cannot be certain that the market for such solutions and services will continue to develop and grow or that these organizations will elect to adopt our solutions and services rather than continue to use traditional, less automated methods, attempt to develop software internally, rely upon legacy software systems, or use software solutions not specifically designed for this market. Organizations that have already invested substantial resources in other fundraising methods or other non-integrated software solutions might be reluctant to adopt our solutions and services to supplement or replace their existing systems or methods. In addition, the implementation of one or more of our core software solutions can involve significant time and capital commitments by our customers, which they may be unwilling or unable to make. If demand for and market acceptance of our solutions and services does not increase, we might not grow our business as we expect.

A reduction in the growth or amount of charitable giving could aversely affect our operating results and financial condition.

A large percentage of our customers are nonprofits, foundations, education institutions, healthcare organizations and other members of the social good community that rely on charitable donations. If charitable giving, including online giving, does not continue to grow or declines, it could limit our current and potential customers' ability to use and pay for our solutions and services, which could adversely affect our operating results and financial condition.

In addition, we derive a significant portion of our revenue from transaction-based payment processing fees that we collect from our customers through our Blackbaud Merchant Services solution, which enables our customers' donors to make donations and purchase goods and services using various payment options. A reduction in the growth of, or a decline in, charitable giving to these customers, whether due to deteriorating general economic conditions, the impact of recent or future changes to applicable tax laws, or otherwise, could negatively impact the volume and size of such payment processing transactions and thereby adversely affect our operating results and financial condition.

If we are unable, or our customers believe we are unable, to detect and prevent unauthorized use of payment card information and safeguard confidential donor data, we could be subject to financial liability, our reputation could be harmed and customers may be reluctant to use our solutions and services.

The rules of payment card associations in which we participate require that we comply with Payment Card Industry Data Security Standard ("PCI DSS") in order to preserve security of payment card data. Under PCI DSS, we are required to adopt and implement internal controls over the use, storage and security of payment card data to help prevent card fraud. Conforming our solutions and services to PCI DSS or other payment services related regulations or requirements imposed by payment networks or our customers or payment processing partners is expensive and time-consuming. However, failure to comply may subject us to fines, penalties, damages and civil liability, may impair the security of payment card data in our possession, and may harm our reputation and our business prospects, including by limiting our ability to process transactions. Currently some of our solutions are not fully compliant with PCI DSS, primarily due to the lag time required for integrating acquired businesses.

If the security of our software is breached, we fail to securely collect, store and transmit customer information, or we fail to safeguard confidential donor data, we could be exposed to liability, litigation, penalties and remedial costs and our reputation and business could suffer.

Fundamental to the use of our solutions is the secure collection, storage and transmission of confidential donor and end user data and transaction data, including in our payment services. Despite the network and application security, internal control measures, and physical security procedures we employ to safeguard our systems, we may still be vulnerable to a security

breach, intrusion, loss or theft of confidential donor data and transaction data, which may harm our business, reputation and future financial results.
Like many major businesses, we are, from time to time, a target of cyber-attacks and phishing schemes, and we expect these threats to continue. Because of the numerous and evolving cybersecurity threats, including advanced and persistent cyber-attacks, phishing and social engineering schemes, used to obtain unauthorized access, disable or degrade systems have become increasingly more complex and sophisticated and may be difficult to detect for periods of time, we may not anticipate these acts or respond adequately or timely. As these threats continue to evolve and increase, we may be required to devote significant additional resources in order to modify and enhance our security controls and to identify and remediate any security vulnerabilities.
A compromise of our data security that results in customer or donor personal or payment card data being obtained by unauthorized persons could adversely affect our reputation with our customers and others, as well as our operations, results of operations, financial condition and liquidity and could result in litigation against us or the imposition of penalties.

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We might be required to expend significant capital and other resources to protect further against security breaches or to rectify problems caused by any security breach, including notification under data privacy laws and regulations and expenses related to remediating our information security systems. Even though we carry cyber-technology insurance policies that may provide insurance coverage under certain circumstances, we might suffer losses as a result of a security breach that exceed the coverage available under our insurance policies or for which we do not have coverage. A security breach and any efforts we make to address such breach could also result in a disruption of our operations, particularly our online sales operations.

Further, the existence of vulnerabilities, even if they do not result in a security breach, may harm client confidence and require substantial resources to address, and we may not be able to discover or remedy such security vulnerabilities before they are exploited, which may harm our business, reputation and future financial results.

Privacy and data protection concerns, including evolving domestic and international government regulation in the area of consumer data privacy or data protection, could adversely affect our business and operating results.

The effectiveness of our software solutions relies on our customers' storage and use of data concerning their customers, including financial, personally identifying or other sensitive data. Our customers' collection and use of this data for donor profiling, data analytics or communications outreach might raise privacy and data protection concerns and negatively impact the demand for our solutions and services. For example, our custom modeling and analytical services rely heavily on processing and using of data we gather from customers and various sources. Privacy and data protection laws could restrict or add regulatory and compliance processes to our ability to market and profit from those services.

Governments in some jurisdictions have enacted or are considering enacting consumer data privacy or data protection legislation, including laws and regulations applying to the solicitation, collection, transfer, processing and use of personal data. This legislation could reduce the demand for our software solutions if we fail to design or enhance our solutions to enable our customers to comply with the privacy and data protection measures required by the legislation. Moreover, we may be exposed to liability under existing or new consumer privacy or data protection legislation. For example, when providing our solutions to certain customers in the healthcare industry, we must comply with applicable provisions of the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"), and might be subject to similar provisions of the Gramm-Leach-Bliley Act and related regulations. We are currently evaluating operational and solution changes that need to be made to allow us and our customers to comply with the California Consumer Privacy Act of 2018, which will become effective January 1, 2020, and may apply to some of our customers and areas of business. Even technical violations of these laws may result in penalties that are assessed for each non-compliant transaction.

Recently, the European Union ("EU") General Data Protection Regulation (“GDPR”), which became effective in May 2018, extended the scope of the EU data protection law to many companies processing data of EU residents, regardless of the company’s location. The law requires companies to meet new requirements regarding the handling of personal data, including new rights such as the portability of personal data. We completed an extensive program of product and operational changes to address GDPR requirements and all future solutions sold to customers subject to GDPR must include GDPR features. The implementation of GDPR has affected our ability to offer some features and services to customers in the EU.

Furthermore, actions and investigations by regulatory authorities related to data security incidents and privacy violations continue to increase, which could impact us through increased costs or restrictions on our business, and noncompliance could result in significant regulatory penalties and legal liability.

If our customers or we were found to be subject to and in violation of any privacy or data protection laws or regulations, our business may be materially and adversely impacted and we and/or our customers would likely have to change our business practices. In addition, these laws and regulations could impose significant costs on our customers and us and make it more difficult for donors to make online donations.

We are in the information technology business, and our solutions and services store, retrieve, transfer, manipulate and manage our customers' information and data. The effectiveness of our software solutions relies on our customers' storage and use of data concerning their donors, including financial, personally identifying and other sensitive data and our business uses similar systems that require us to store and use data with respect to our customers and personnel. Our collection and our customers' collection and use of this data might raise privacy and data protection concerns and negatively impact our business or the demand for our solutions and services. If a breach of data security were to occur, or other violation of privacy or data protection laws and regulations were to be alleged, our business may be materially and adversely impacted and solutions may be perceived as less desirable, which would negatively affect our business and operating results.

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If we fail to respond to technological changes or successfully introduce new and improved solutions, our competitive position may be harmed and our business may suffer.

The introduction of solutions encompassing new technologies can render existing solutions obsolete and unmarketable. As a result, our future success will depend, in part, upon our ability to continue to enhance existing solutions and develop and introduce in a timely manner or acquire new solutions that keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance. If we are unable to develop or acquire on a timely and cost-effective basis new software solutions or enhancements to existing solutions or if such new solutions or enhancements do not achieve market acceptance, our business, results of operations and financial condition may be materially adversely affected.

Because competition for highly qualified personnel is intense, we might not be able to attract and retain key personnel needed to support our planned growth.

To meet our objectives successfully, we must attract and retain highly qualified personnel with specialized skill sets. If we are unable to attract suitably qualified management, there could be a material adverse impact on our business.

Further, in the past, we have used equity incentive programs as part of our overall employee compensation agreements to both attract and retain personnel. A decline in our stock price could negatively impact the value of these equity incentive and related compensation programs as retention and recruiting tools. We may need to create new or additional equity incentive programs and/or compensation packages to remain competitive, which could be dilutive to our existing stockholders and/or adversely affect our results of operations.

If we do not successfully address the risks inherent in the expansion of our international operations, our business could suffer.

We currently have non-U.S. operations primarily in the United Kingdom, Canada, Australia and Costa Rica, and we intend to expand further into international markets. Expansion of our international operations will require a significant amount of attention from our management and substantial financial resources and might require us to add qualified management in these markets. Our direct sales model requires us to attract, retain and manage qualified sales personnel capable of selling into markets outside the United States. In some cases, our costs of sales might increase if our customers require us to sell through local distributors.

If we are unable to grow our international operations in a cost-effective and timely manner, our business and operating results could be harmed. Doing business internationally involves additional risks that could harm our operating results.

We expect that an increasing portion of our international revenues will be denominated in foreign currencies, subjecting us to fluctuations in foreign currency exchange rates. If we expand our international operations, exposures to gains and losses on foreign currency transactions may increase.

Along with risks similar to those faced by our U.S. operations, our international operations are also subject to risks related to differing legal, political, social and regulatory requirements and economic conditions, including:

- the imposition of additional withholding taxes or otherwise tax our foreign income, impose tariffs or adopt other restrictions on foreign trade or investment, including currency exchange controls;
- greater risk of a failure of our employees and partners to comply with both U.S. and foreign laws, including antitrust regulations, the U.S. Foreign Corrupt Practices Act, the U.K. Bribery

Act of 2010, and any trade regulations ensuring fair trade practices; and

- the imposition of, or unexpected adverse changes in, foreign laws or regulatory requirements may occur, including those pertaining to export restrictions, privacy and data protection, trade and employment restrictions and intellectual protections.

The vote by the U.K. to leave the EU could adversely affect us.

The UK held a referendum on June 23, 2016 on its membership in the EU, in which a majority of UK voters voted to exit the EU (commonly referred to as "Brexit"). The referendum was advisory, and the terms of any withdrawal are subject to

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a negotiation period triggered by the U.K.’s formal initiation of the withdrawal process, which began in March 2017 and is set to expire in 2019, unless otherwise extended. These negotiations will determine the future terms of the U.K.'s relationship with the EU, including the terms of trade between the U.K. and the EU. The ultimate effects of Brexit on us are difficult to predict, but because we currently conduct business in the UK and in Europe, the results of the referendum and any eventual withdrawal creates uncertainty and could disrupt our business. For example, Brexit could affect the business of and/or our relationships with our customers and partners, as well as alter the relationship among tariffs and currencies, including the value of the British Pound and the Euro relative to the US dollar. Any of these effects of Brexit, and others we cannot anticipate, could adversely affect our business, business opportunities, results of operations, financial condition and cash flows.

Unfavorable media coverage related to peer-to-peer fundraising campaigns on our social platforms could negatively impact our business.

Our online social giving platforms receive a high degree of media coverage for particularly news-worthy or controversial fundraising campaigns, as well as for our fee-based business model. Although our terms of service provide express limitations on the platforms' user-initiated fundraising campaigns and reserve our right to remove content that violates our terms of service, it may not always be possible to remove such content prior to it receiving attention in the media. Negative publicity related to our online social giving platforms could have an adverse effect on the size, engagement and loyalty of our user base and could result in decreased revenue, which could adversely affect our business and financial results.

Acquisitions could prove difficult to integrate, disrupt our business, dilute stockholder value and strain our resources.

As part of our business strategy, we have made acquisitions and continue to evaluate opportunities to acquire companies, technologies and/or services. The successful integration of acquired companies requires, among other things, coordination of various departments, including solution development, engineering, sales and marketing and finance, as well as integration in our system of internal controls. Acquisitions and investments involve numerous risks.

Acquisitions also frequently result in recording of goodwill and other intangible assets, which are subject to potential impairments in the future that could harm our operating results. In addition, if we finance acquisitions by issuing equity securities or securities convertible into equity securities, our existing stockholders would be diluted which, in turn, could affect the market price of our stock. Moreover, we could finance any acquisition with debt, resulting in higher leverage and interest costs. As a result, if we fail to evaluate and execute acquisitions or investments properly, we might not achieve the anticipated benefits of any such acquisition and we may incur costs in excess of what we anticipate. Furthermore, if we incur additional debt to fund acquisitions and are unable to service our debt obligation we may have a greater risk of default under our credit facility. In addition, acquisitions may cause a disruption to our ongoing business, including diversion of resources and management's attention from our existing business and a greater than expected investment of resources or operating expenses.

The success of our acquisitions will depend in part on our ability to retain their engineering, sales, marketing, development and other personnel. It is possible that these employees might decide to terminate their employment. If key employees terminate their employment, the sales, marketing or development activities of acquired companies might be adversely affected, our management's attention might be diverted from successfully integrating the acquired operations to hiring suitable replacements and, as a result, our business might suffer.

We significantly increased our leverage in connection with acquisitions.

We incurred a substantial amount of indebtedness in connection with recent acquisitions. As a result of this indebtedness, our interest payment obligations have increased. The degree to which we are leveraged could have adverse effects on our business, including the following:

- Requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions, dividends and other general corporate purposes;
- Limiting our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate;

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- Restricting us from making additional strategic acquisitions or exploiting business opportunities;
- Placing us at a competitive disadvantage compared to our competitors that have less debt;
- Limiting our ability to borrow additional funds; and
- Decreasing our ability to compete effectively or operate successfully under adverse economic and industry conditions.

If we incur additional debt, these risks may intensify. Our ability to meet our debt service obligations will depend upon our future performance, which will be subject to the financial, business and other factors affecting our operations, many of which are beyond our control.

Our balance sheet includes significant amounts of goodwill and intangible assets. The impairment of a significant portion of these assets could negatively affect our operating results.

As of December 31, 2018, we had $545.2 million and $291.6 million of goodwill and intangible assets, respectively. On at least an annual basis, we assess whether there have been impairments in the carrying value of goodwill and intangible assets. If the carrying value of an asset is determined to be impaired, then it is written down to fair value by a non-cash charge to operating earnings. Changes in circumstances that could indicate that the carrying value of goodwill or intangible assets may not be recoverable include declines in our stock price, market capitalization, cash flows and slower growth rates in our industry. We cannot accurately predict the likelihood or potential amount and timing of any impairment of goodwill or other intangible assets. An impairment of a significant portion of goodwill or intangible assets could materially and negatively affect our results of operations and financial condition.

Restrictions in our credit facility may limit our activities, including dividend payments, share repurchases and acquisitions.

Our credit facility contains restrictions, including covenants limiting our ability to incur additional debt, grant liens, make acquisitions and other investments, prepay specified debt, consolidate, merge or acquire other businesses, sell assets, pay dividends and other distributions, repurchase stock and enter into transactions with affiliates. There can be no assurance that we will be able to remain in compliance with the covenants to which we are subject in the future and, if we fail to do so, that we will be able to obtain waivers from our lenders or amend the covenants.

In the event of a default under our credit facility, we could be required to immediately repay all outstanding borrowings, which we might not be able to do. In addition, certain of our material domestic subsidiaries are required to guarantee amounts borrowed under the credit facility, and we have pledged the shares of certain of our subsidiaries as collateral for our obligations under the credit facility. Any such default could have a material adverse effect on our ability to operate, including allowing lenders under the credit facility to enforce guarantees of our subsidiaries, if any, or exercise their rights with respect to the shares pledged as collateral.

We have recorded significant deferred tax assets, and we might never realize their full value, which would result in a charge against our earnings.

As of December 31, 2018, we had deferred tax assets of $51.1 million. Realization of our deferred tax assets is dependent upon our generating sufficient taxable income in future years to realize the tax benefit from those assets. Deferred tax assets are reviewed at least annually for realizability. A charge against our earnings would result if, based on the available evidence, it is more likely than not that some portion of the deferred tax asset will not be realized beyond our existing valuation allowance. This could be caused by, among other things, deterioration in performance, adverse market conditions, adverse changes in applicable laws or regulations, including changes that restrict the activities of or affect the solutions sold by our business and a variety of other factors. If a deferred tax asset net of our valuation allowance was determined to be not realizable in a future period, the charge to earnings would be recognized as an expense in our results of operations in the period the determination is made. Additionally, if we are unable to utilize our deferred tax assets, our cash flow available to fund operations could be adversely affected.

Depending on future circumstances, it is possible that we might never realize the full value of our deferred tax assets. Any future impairment charges related to a significant portion of our deferred tax assets would have an adverse effect on our financial condition and results of operations.

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Claims that we or our technologies infringe upon the intellectual property or other proprietary rights of a third party may require us to incur significant costs, enter into royalty or licensing agreements or develop or license substitute technology.

We may be subject to claims that our technologies in our solutions and services infringe upon the intellectual property or other proprietary rights of a third party. In addition, the vendors providing us with technology that we use in our own technology could become subject to similar infringement claims. Although we believe that our solutions and services do not infringe any intellectual property or other proprietary rights, we cannot be certain that our solutions and services do not, or that they will not in the future, infringe intellectual property or other proprietary rights held by others. Any claims of infringement could cause us to incur substantial costs defending against the claim, even if the claim is without merit, and could distract our management from our business. Moreover, any settlement or adverse judgment resulting from the claim could require us to pay substantial amounts, or obtain a license to continue to use the solutions and services that are the subject of the claim, and/or otherwise restrict or prohibit our use of the technology. There can be no assurance that we would be able to obtain a license on commercially reasonable terms from the third party asserting any particular claim, or that we would be able to successfully develop alternative technology on a timely basis, or that we would be able to obtain a license from another provider of suitable alternative technology to permit us to continue offering, and our customers to continue using, the solutions and services. In addition, we generally provide in our customer arrangements for certain solutions and services that we will indemnify our customers against third-party infringement claims relating to technology we provide to those customers, which could obligate us to pay damages if the solutions and services were found to be infringing. Infringement claims asserted against us, our vendors or our customers may have a material adverse effect on our business, prospects, financial condition and results of operations.

Our solutions utilize open source software, which may subject us to litigation, require us to re-engineer our solutions, or otherwise divert resources away from our development efforts.

We use open source software in connection with certain of our solutions. Such open source software is generally licensed by its authors or other third parties under open source licenses, including, for example, the GNU General Public License, the GNU Lesser General Public License, "Apache-style" licenses, "BSD-style" licenses and other open source licenses. There is little legal precedent governing the interpretation of many of the terms of some of these licenses and, therefore, the potential impact of these terms on our business is currently unable to be determined and may result in unanticipated obligations regarding our solutions and technologies. From time to time, companies that incorporate open source software into their products have faced claims challenging the ownership of open source software and/or compliance with open source license terms. Therefore, we could be subject to litigation by parties claiming ownership of open source software or noncompliance with open source licensing terms. Some open source software licenses require users who distribute open source software as part of their own software to publicly disclose all or part of the source code to such software and/or make available any derivative works of the open source code on unfavorable terms or at no cost. While we monitor our use of open source software and try to ensure that none is used in a manner that would require us to disclose the source code or that would otherwise breach the terms of an open source agreement, such use could inadvertently occur and we may be required to release proprietary source code, pay damages for breach of contract, re-engineer our applications, discontinue sales in the event re-engineering cannot be accomplished on a timely basis, or take other remedial action that may divert resources away from our development efforts, any of which could adversely affect our business.

We rely upon trademark, copyright, patent and trade secret laws to protect our proprietary rights, which might not provide us with adequate protection.

Our success and ability to compete depends to a significant degree upon the protection of our proprietary technology rights. We might not be successful in protecting our proprietary technology and our proprietary rights might not provide us with a meaningful competitive advantage. To protect our core proprietary technology, we rely on a combination of patent, trademark, copyright and trade secret laws, as well as nondisclosure agreements, each of which affords only limited protection.

Increasing and evolving domestic and international government regulation could affect our business.

Pending and enacted legislation at the state and federal levels and internationally, including those related to taxation, fundraising activities and payment processing, may also restrict further our information gathering and disclosure practices, for example, by requiring us to comply with extensive and costly registration, reporting or disclosure requirements. Any substantial increase in government regulation affecting our business, or any failure to comply with existing regulations, could require substantial investments to achieve compliance, which could adversely affect our operating results and financial condition.

Our operations might be affected by the occurrence of a natural disaster or other catastrophic event.

We depend on our principal executive offices and other facilities for the continued operation of our business. Although we have contingency plans in effect for natural disasters or other catastrophic events, these events, including terrorist attacks, computer hacker attacks and natural disasters such as hurricanes, flooding and earthquakes, could disrupt one or more of these facilities and adversely affect our operations. Our principal executive offices are located in a coastal region that has experienced hurricanes in the past. Even though we carry business interruption insurance policies and typically have provisions in our commercial contracts that protect us in certain events, we might suffer losses as a result of business interruptions that exceed the coverage available under our insurance policies or for which we do not have coverage. Any natural disaster or catastrophic event affecting us could have a significant negative impact on our operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease our new headquarters facility in Charleston, South Carolina, which consists of approximately 172,000 square feet (the "New Headquarters Facility"). The lease on our New Headquarters Facility expires in April 2038 and we have the option for four 5-year renewal periods. The lease agreement also grants us a Phase Two option to request that the landlord construct and lease to us a second office building and related improvements. We continue to lease our former headquarters facility, now called our Customer Operations Center, in Charleston, South Carolina, which consists of approximately 218,000 square feet. The lease on our Customer Operations Center expires in October 2023, and we have the option for two 5-year renewal periods.

We also lease or have purchased the right to use additional office space in Austin, Texas; Bedford, New Hampshire; Charleston, South Carolina; Glasgow, Scotland; London, England; Plano, Texas; St. Paul, Minnesota; San Jose, Costa Rica; Sydney, Australia; and Toronto, Canada, among other locations. We believe that our properties are in good operating condition and adequately serve our current business operations. We also anticipate that suitable additional or alternative space, including those under lease options, will be available at commercially reasonable terms for future expansion.

ITEM 3. LEGAL PROCEEDINGS

From time to time we may become involved in litigation relating to claims arising from our ordinary course of business. We do not believe that there are any claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on us.

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 trading on the Nasdaq Stock Market LLC (“Nasdaq”) under the symbol “BLKB.” As of February 4, 2019, there were approximately 104 stockholders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, this number is not representative of the total number of stockholders represented by these stockholders of record. On February 4, 2019, the closing price of our common stock was $70.07.

Stock Performance Graph

The following performance graph shall not be deemed to be “soliciting material” or “filed” or incorporated by reference in future filings with the SEC, or subject to the liabilities of Section 18 of the Exchange Act except as shall be expressly set forth by specific reference in such filing. The performance graph compares the performance of our common stock to the Nasdaq Composite Index and the Nasdaq Computer and Data Processing Index. The graph covers the most recent five-year period ended December 31, 2018. The graph assumes that the value of the investment in our common stock and each index was $100.00 at December 31, 2013, and that all dividends are reinvested.

Blackbaud, Inc.	$100.00	$116.44	$178.87	$175.15	$260.07	$174.04
Nasdaq Composite Index	100.00	114.62	122.81	133.19	172.11	165.84
Nasdaq Computer & Data Processing Index	100.00	113.68	140.03	150.12	209.72	212.97

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Common Stock Acquisitions and Repurchases

The following table provides information about shares of common stock acquired or repurchased during the three months ended December 31, 2018. All of these acquisitions were of common stock withheld by us to satisfy minimum tax obligations of employees due upon exercise of stock appreciation rights and vesting of restricted stock awards and units. The level of acquisition activity varies from period to period based upon the timing of grants and vesting as well as employee exercise decisions.

Beginning balance, October 1, 2018				$ 50,000
October 1, 2018 through October 31, 2018	195	$ 73.91	—	50,000
November 1, 2018 through November 30, 2018	3,717	73.38	—	50,000
December 1, 2018 through December 31, 2018	—	—	—	50,000
Total	3,912	$ 73.41	—	$ 50,000

(1) In August 2010, our Board of Directors approved a stock repurchase program that authorized us to purchase up to $50.0 million of our outstanding shares of common stock. We have not made any repurchases under the program to date, and the program does not have an expiration date.

Dividend Policy

Our Board of Directors has adopted a dividend policy which reflects an intention to distribute to our stockholders a portion of the cash generated by our business that exceeds our operating needs and capital expenditures as regular quarterly dividends. This policy reflects our judgment that we can provide greater value to our stockholders by distributing to them a portion of the cash generated by our business.

In accordance with this dividend policy, we paid quarterly dividends at an annual rate of $0.48 per share in 2018 and 2017, resulting in aggregate dividend payments to stockholders of $23.3 million and $23.1 million in 2018 and 2017, respectively. In February 2019, our Board of Directors approved an annual dividend rate of $0.48 per share for 2019 and we declared a first quarter dividend of $0.12 per share payable on March 15, 2019, to stockholders of record on February 27, 2019.

Dividends on our common stock will not be cumulative. Consequently, if dividends on our common stock are not declared and/or paid at the targeted level, our stockholders will not be entitled to receive such payments in the future. We are not obligated to pay dividends, and as described more fully below, our stockholders might not receive any dividends as a result of the following factors:

- Our credit facility limits the amount of dividends we are permitted to pay;
- Our Board of Directors could decide to reduce dividends or not to pay dividends at all, at any time and for any reason;
- The amount of dividends distributed is subject to state law restrictions (as discussed below); and
- We might not have enough cash to pay dividends due to changes to our operating earnings, working capital requirements and anticipated cash needs.

Assumptions and Considerations

We estimate that the cash necessary to fund dividends on our common stock for 2019 at an annual rate of $0.48 per share is approximately $23.5 million (assuming 49.0 million shares of common stock are outstanding, net of treasury stock).

We have a stock repurchase program that authorizes us to purchase up to $50.0 million of our outstanding shares of common stock. The program does not have an expiration date. The shares could be purchased in a self-tender for our stock, from time to time on the open market or in privately negotiated transactions depending upon market conditions

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and other factors, all in accordance with the requirements of applicable law. Any open market purchases under the repurchase program will be made in compliance with Rule 10b-18 of the Securities Exchange Act of 1934 and all other applicable securities regulations. We might not purchase any shares of common stock and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, to cancel the stock repurchase program.

We believe that our cash on hand and the cash flows we expect to generate from operations will be sufficient to meet our liquidity requirements through 2019, including dividends and purchases under our stock repurchase program. See “Management’s Discussion and Analysis of Financial Conditions and Results of Operations — Liquidity and Capital Resources” in Item 7 in this report.

If our assumptions as to operating expenses, working capital requirements and capital expenditures are too low or if unexpected cash needs arise that we are not able to fund with cash on hand or with borrowings under our credit facility, we would need to either reduce or eliminate dividends. If we were to use working capital or permanent borrowings to fund dividends, we would have less cash available for future dividends and other purposes, which could negatively impact our stock price, financial condition, results of operations and ability to maintain or expand our business.

We have estimated our dividend only for 2019, and we cannot assure our stockholders that during or following 2019 we will pay dividends at the estimated levels, or at all except with regard to dividends previously declared by the Board of Directors but not yet paid. We are not required to pay dividends and our Board of Directors may modify or revoke our dividend policy at any time. Dividend payments are within the absolute discretion of our Board of Directors and will be dependent upon many factors and future developments that could differ materially from our current expectations. Over time, our capital and other cash needs, including unexpected cash needs, will invariably change and remain subject to uncertainties, which could impact the level of any dividends we pay in the future.

We believe that our dividend policy could limit, but not preclude, our ability to pursue growth as we intend to retain sufficient cash after the distribution of dividends to permit the pursuit of growth opportunities. In order to pay dividends at the level currently anticipated under our dividend policy and to fund any substantial portion of our stock repurchase program, we could require financing or borrowings to fund any significant acquisitions or to pursue growth opportunities requiring capital significantly beyond our anticipated levels. Management will evaluate potential growth opportunities as they arise and, if our Board of Directors determines that it is in our best interest to use cash that would otherwise be available for distribution as dividends to pursue an acquisition opportunity, to materially increase capital spending or for some other purpose, the Board would be free to depart from or change our dividend policy at any time.

Restrictions on Payment of Dividends

Under Delaware law, we can only pay dividends either out of “surplus” (which is defined as total assets at fair market value minus total liabilities, minus statutory capital) or out of current or the immediately preceding year’s earnings. As ofDecember 31, 2018, we had $30.9 million in cash and cash equivalents. In addition, we anticipate that we will have sufficient earnings in 2019 to pay dividends at the level described above. Although we believe we will have sufficient surplus and earnings to pay dividends at the anticipated levels for 2019, our Board of Directors will seek periodically to assure itself of this sufficiency before actually declaring any dividends.

Under our credit facility, we also have restrictions on our ability to declare and pay dividends and our ability to repurchase shares of our common stock. In order to pay any cash dividends and/or repurchase shares of stock: (1) no default or event of default shall have occurred and be continuing under the credit facility, and (2) our pro forma net leverage ratio, as set forth in the credit agreement, must be 0.25 less than the net leverage ratio requirement at the time of dividend declaration or share repurchase. See “Management’s Discussion and Analysis of Financial Conditions and Results of Operations — Liquidity and Capital Resources” in Item 7 in this report.

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ITEM 6. SELECTED FINANCIAL DATA

The selected financial data set forth below should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7 in this report and our financial statements and the related notes included elsewhere in this report to fully understand factors, including our business acquisitions and dispositions, that may affect the comparability of the information presented below.

	Year ended December 31,				
SUMMARY OF OPERATIONS					
Total revenue	$848,606	$788,487	$731,642	$637,940	$564,421
Total cost of revenue	381,742	361,904	339,220	304,631	273,438
Gross profit	466,864	426,583	392,422	333,309	290,983
Total operating expenses	407,447	358,405	324,198	286,597	244,619
Income from operations	59,417	68,178	68,224	46,712	46,364
Net income	44,841	73,633	45,404	25,649	28,290
PER SHARE DATA					
Basic net income	$0.95	$1.58	$0.98	$0.56	$0.63
Diluted net income	0.93	1.54	0.96	0.55	0.62
Cash dividends	0.48	0.48	0.48	0.48	0.48
BALANCE SHEET DATA					
Total assets[(1)]	$1,615,305	$1,797,846	$1,345,009	$1,223,336	$942,503
Deferred revenue, including current portion	298,555	278,706	250,289	237,335	221,274
Total debt, including current portion[(1)]	387,124	438,224	342,393	408,087	279,891
Total long-term liabilities[(1)]	435,867	486,946	396,466	446,450	335,583

(1) As previously disclosed, on January 1, 2016, we adopted ASU 2015-03, Interest - Imputation of Interest - Simplifying the Presentation of Debt Issuance Costs, on a retrospective basis. Accordingly, we retrospectively adjusted other non-current assets and debt, net of current portion, which had the effect of reducing each of those respective line items in our consolidated balance sheets as of December 31, 2015 and 2014 by approximately $0.5 million and $0.7 million, respectively.

(2) Reflects the impact of adopting the new accounting standard in 2018 related to revenue recognition. See Note 2 of our consolidated financial statements in this report for further discussion.

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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 Item 1A Risk factors and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The following discussion and analysis presents financial information denominated in millions of dollars which can lead to differences from rounding when compared to similar information contained in the consolidated financial statements and related notes which are primarily denominated in thousands of dollars.

Executive Summary

We are the world’s leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, companies, education institutions, healthcare organizations and individual change agents—we connect and empower organizations to increase their impact through cloud software, services, expertise and data intelligence. Our portfolio is tailored to the unique needs of vertical markets, with solutions for fundraising and CRM, marketing, advocacy, peer-to-peer fundraising, corporate social responsibility, school management, ticketing, grantmaking, financial management, payment processing and analytics. Serving the industry for more than three decades, we are headquartered in Charleston, South Carolina and have operations in the United States, Australia, Canada, Costa Rica and the United Kingdom. As of December 31, 2018, we had over 45,000 customers.

Our revenue is primarily generated from the following sources: (i) charging for the use of our software solutions in cloud-based and hosted environments; (ii) providing payment and transaction services; (iii) providing software maintenance and support services; and (iv) providing professional services, including implementation, consulting, training, analytic and other services.

During 2018, we continued to execute our four-point growth strategy targeted to drive an extended period of solution and service innovation, quality enhancement, increased operating efficiency and improved financial performance:

Four-Point Growth Strategy

1. *Integrated and Open Solutions in the Cloud*

We will continue to transition our business to predominantly serve customers through a subscription-based cloud delivery model, enabling lower cost of entry, greater scalability and lower total cost of ownership to our customers. We continue to optimize our portfolio of solutions and integrate powerful capabilities — such as built-in data analytics, payment services and tailored user experiences — to bring even greater value and performance to our customers. During 2018, we made several portfolio announcements, ranging from solution integrations to new capabilities for existing solutions to new solution introductions. We introduced our Cloud Solution for Faith Communities, which combines our proven strength in financial management, fundraising, marketing, payments and analytics with our completely new Church Management capabilities. With this move, we now will provide integrated end-to-end cloud capabilities that enable churches to digitally transform their operations through a single connected experience. We also announced our Cloud Solution for Higher Education, introducing a new Education Management portfolio, along with stewardship management and guided fundraising capabilities tailored for higher education. This new cloud solution will enable customers to manage the complete student life cycle, from admissions to alumni engagement, student enrollment, classroom scheduling and a student information system. We also announced the Integrated Cloud Initiative for Nonprofits, a joint investment with Microsoft to accelerate cloud innovation in areas that address critical market needs across the mission life cycle of nonprofits. As part of this initiative, we are jointly developing a solution called Nonprofit Resource Management, which is a breakthrough in helping nonprofits effectively source, track, distribute and measure the impact of their resources across core business processes for managing the distribution of everything from material goods to financial and human capital.

Blackbaud, Inc.

2. Drive Sales Effectiveness

We are making investments to increase the effectiveness of our sales organization, with a focus on enabling our expanding sales teams with the talent, processes and tools to accelerate our revenue growth and improve effectiveness. Our sales teams are now managed on a common sales operating model. This model, which is driving increased productivity, includes common procedures, training, key operating metrics, compensation plans and reporting. Our sales account executives now lead with a total-solution selling strategy by vertical, focused on recurring revenue and driving more products per customer, higher ASPs and increased customer retention over the long-term. We believe that attaching training, analytics and payments improves the cloud experience, drives customer outcomes, improves retention and increases customer lifetime value. We continue to innovate and acquire solutions that create greater value for our customers. We spent the second half of 2018 ramping our direct sales hiring resulting in an increase in sales headcount of 19% since the end of 2017. We expect to continue making similar investments during 2019 and beyond. These incremental investments are intended to address the large market opportunity that we see for ourselves and fuel future revenue growth. Also, our partnership with Microsoft is gaining momentum with Microsoft introducing us to new joint-selling opportunities.

3. Expand TAM into Near Adjacencies with Acquisitions and Product Investments

We will continue to evaluate compelling opportunities to acquire companies and acquire or build technologies and services. We will be guided by our acquisition criteria for considering attractive assets that expand our TAM, provide entry into new and near adjacencies, accelerate our shift to the cloud, accelerate revenue growth, are accretive to margins and present synergistic opportunities.

In 2018, we announced our Cloud Solution for Faith Communities, our expanded Cloud Solution for Higher Education and the Integrated Cloud Initiative for Nonprofits, demonstrating that we are now in a position to organically build and not just acquire incremental TAM. These solution introductions added approximately $2 billion to our TAM.

We also acquired Reeher in the second quarter of 2018 to bolster our extensive performance benchmarking capabilities. In addition, our recent acquisition of YourCause (discussed below), which closed on the first business day in January 2019, added another half-billion dollars to our TAM. Our TAM now stands at over $10 billion.

4. Improve Operating Efficiency

We continue driving towards a more scalable operating model that creates efficiency and consistency in how we execute through infrastructure investments, productivity initiatives, and organizational re-alignments. Our organizational model, which we have evolved over the past few years, is largely complete and allows us to gain efficiency and consistency in how we execute. We have centralized our operations, including marketing, sustained engineering, product management, finance, customer support, customer success and professional services, which allows us to better manage the entire customer experience. We also created an operational excellence function inside of Blackbaud that focuses on maximizing the effectiveness of the business through continuous improvement.

In 2018, we continued executing against a cohesive workplace strategy in an effort to improve operating efficiency and further our organizational objectives, with our geographically diverse workforce. We also furthered our efforts to relocate some of our existing offices to highly modern and more collaborative workspaces with short-term financial commitments. These workspaces are more centrally located for our employees and closer to our customers. Our aim is optimizing our office utilization, improving our geographic sales coverage, and enhancing our employees' daily experience to improve productivity and effectiveness. We have continued this initiative into 2019 and expect to be largely complete by the end of this year. For additional financial details, see "Restructuring" below.

We have also begun near-shoring certain functions such as customer operations and support on a selective basis to Costa Rica, enabling efficient resource investment to support our growing business.

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Blackbaud, Inc.

Total revenue

Total revenue	$848.6	7.6 %	$788.5

Total revenue increased by $60.1 million during 2018, which was primarily driven by growth in recurring revenue as we continue to see positive demand from customers across our portfolio of cloud-based solutions. The inclusion of JustGiving and Reeher also contributed to the increases in recurring and total revenue. One-time services and other revenue declined during 2018 from our continued shift in focus towards selling cloud-based subscription solutions. In general, our cloud-based solutions include integrated analytics, training and payment services, and require less implementation services and little to no customization services. We are also selling more subscription-based contracts for professional services and services embedded in our renewable cloud-based solution contracts. As a result, we expect one-time services revenue will continue to decline and total revenue growth will continue to be negatively impacted. In addition, we have also used promotions and discounts for our consulting services as incentives to accelerate the migration of our existing customer base from on-premises solutions toward our cloud-based solutions.

Income from operations

Income from operations	$59.4	(12.9)%	$68.2

Income from operations decreased by $8.8 million during 2018, when compared to 2017. The positive impact of growth in total revenue driven by recurring subscriptions was offset primarily by investments we are making in our sales organization and innovation, which we expect to continue in 2019 and beyond. Increases in stock-based compensation of $7.6 million, restructuring costs of $3.8 million and amortization of intangible assets from business combinations of $3.7 million also negatively impacted income from operations during 2018. The increase in stock-based compensation expense was primarily driven by an increase in the grant date fair value of our annual equity awards granted to employees during 2018, when compared to the grant date fair value of the awards granted during 2017.

Customer retention

Our recurring revenue contracts are generally for a term of three years at contract inception with one to three-year renewals thereafter. We anticipate a continued decrease in maintenance contract renewals as we transition our solution portfolio and maintenance customers from a perpetual license-based model to a cloud-based subscription delivery model. In the long term, we also anticipate an increase in recurring subscription contract renewals as we continue focusing on innovation, quality and the integration of our cloud-based solutions, which we believe will provide value-adding capabilities to better address our customers' needs. Due primarily to these factors, we believe a recurring revenue customer retention measure that combines recurring subscription, maintenance and service customer contracts provides a better representation of our customers' overall behavior. During 2018, approximately 92% of our customers with recurring revenue contracts were retained. This customer retention rate reflects a modest decrease from our rate of approximately 93% for 2017 and was driven by our efforts to rationalize our portfolio of solutions and migrate customers from legacy solutions towards our next generation cloud-based solutions. We are investing in innovation and our customer success program, which we believe will increase customer retention over the long-term.

Balance sheet and cash flow

At December 31, 2018, our cash and cash equivalents were $30.9 million and the carrying amount of our debt under the 2017 Credit Facility was $387.1 million. Our net leverage ratio was 1.87 to 1.00.

During 2018, we generated $201.4 million in cash flow from operations, had net cash outlays of $44.9 million, primarily for the acquisition of Reeher, returned $23.3 million to stockholders by way of dividends and had cash outlays of $52.3 million for purchases of property and equipment and capitalized software development costs.

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Blackbaud, Inc.

Recent development - YourCause acquisition

On January 2, 2019, we acquired YourCause for $157.0 million in cash, subject to certain adjustments set forth in the agreement and plan of merger. The acquisition expands our footprint in corporate social responsibility and employee engagement and enhances our position as a leader in providing solutions to both nonprofit organizations and for-profit companies committed to addressing social issues. The purchase price and related expenses were funded primarily through borrowings under the 2017 Credit Facility. As a result of the acquisition, YourCause has become a wholly-owned subsidiary of ours. We will include the operating results of YourCause, as well as the assets acquired, liabilities assumed and any goodwill arising from the acquisition, in our consolidated financial statements from the date of the acquisition.

Results of Operations

Reportable segment

We report our operating results and financial information in one operating and reportable segment. See Note 16 of our consolidated financial statements in this report for additional information.

Comparison of 2018 to 2017 and 2017 to 2016

Acquisitions

During 2018 and 2017, we acquired companies that provided us with strategic opportunities to expand our TAM and share of the philanthropic giving market through the integration of complementary solutions and services to serve the changing needs of our customers. The following are the companies we acquired and their respective acquisition dates:

- Reeher LLC ("Reeher") – April 30, 2018;
- Giving Limited ("JustGiving") – October 2, 2017; and
- AcademicWorks, Inc. ("AcademicWorks") – April 3, 2017

We have included the results of operations of acquired companies in our consolidated results of operations from the date of their respective acquisition. We determined that the Reeher, JustGiving and AcademicWorks acquisitions were not material business combinations; therefore, revenue and earnings since the acquisition date and pro forma information are not required or presented. See Note 3 to our consolidated financial statements in this report for a summary of these acquisitions.

Reclassifications

Our revenue from "subscriptions" and "maintenance" and a portion of our "services and other" revenue have been combined within "recurring" revenue beginning in 2018. In order to provide comparability between periods presented, those amounts of revenue have been combined within "recurring" revenue in the previously reported consolidated statements of comprehensive income to conform to presentation of the current period. Similarly, "cost of subscriptions" and "cost of maintenance" and a portion of "cost of services and other" have been combined within "cost of recurring" in the previously reported consolidated statements of comprehensive income to conform to presentation of the current period. "Services and other" revenue has been renamed as "one-time services and other" revenue and consists of revenue that did not meet the description of "recurring" revenue in the consolidated statements of comprehensive income. "Cost of services and other" has been renamed as "cost of one-time services and other" and consists of costs that did not meet the description of those related to "recurring" revenue in the consolidated statements of comprehensive income.

Adoption of New Revenue Accounting Standard

On January 1, 2018, we adopted ASU 2014-09, using the full retrospective method of transition, which requires that the standard be applied to all periods presented. The impacts of adoption are reflected in the financial information herein. For additional details, see Note 2 to our consolidated financial statements in this report.

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Blackbaud, Inc.

Operating results
Recurring

Recurring revenue	$762.2	11.3	%	$684.6	12.4	%	$609.1	
Cost of recurring	305.5	10.0	%	277.6	12.6	%	246.7	
Recurring gross profit(1)	$456.7	12.2	%	$406.9	12.3	%	$362.4	
Recurring gross margin	59.9	%		59.4	%		59.5	%

(1) The individual amounts for each year may not sum to recurring gross profit due to rounding.

Recurring revenue is comprised of fees for the use of our subscription-based software solutions, which includes providing access to cloud-based solutions, hosting services, online training programs, subscription-based analytic services, such as donor acquisitions and data enrichment, and payment services. Recurring revenue also includes fees from maintenance services for our on-premises solutions, services included in our renewable subscription contracts, subscription-based contracts for professional services and variable transaction revenue associated with the use of our solutions.

Cost of recurring revenue is primarily comprised of compensation costs for customer support and production IT personnel, third-party contractor expenses, third-party royalty and data expenses, hosting expenses, allocated depreciation, facilities and IT support costs, amortization of intangible assets from business combinations, amortization of software development costs, transaction-based costs related to payments services including remittances of amounts due to third-parties and other costs incurred in providing support and recurring services to our customers.

We continue to experience growth in sales of our cloud-based solutions as we meet the demand of our customers that increasingly prefer cloud-based subscription offerings with integrated analytics, training and payment services. Recurring subscription contracts are typically for a term of three years at contract inception with one to three-year renewals thereafter. We intend to continue focusing on innovation, quality and integration of our cloud-based solutions, which we believe will drive future revenue growth.

2018 vs. 2017

The increase in recurring revenue during 2018, when compared 2017, was primarily due to positive demand across our portfolio of cloud-based solutions as revenue from subscriptions increased $98.1 million. The inclusion of AcademicWorks, JustGiving and Reeher also contributed to the increase in recurring revenue and their impacts are expected to remain modest in the near term due to U.K. market conditions and our acquisition-related integration efforts. The favorable impact from subscriptions was partially offset by a decrease in maintenance revenue of $20.5 million, during 2018, when compared 2017. The decrease in maintenance revenue was primarily related to our ongoing efforts to migrate our existing customer base from on-premises solutions onto our solutions powered by Blackbaud SKY, our modern cloud platform.

The increase in cost of recurring during 2018, when compared 2017, was primarily due to an increase in transaction-based costs of $9.4 million, directly related to an increase in transactional revenue. Also contributing to the increase in cost of recurring revenue were increases in data center costs of $5.9 million, amortization of software development costs of $3.5 million, allocations of depreciation, facilities and IT support costs of $2.7 million and compensation costs, driven by resource additions that are directly related to generating recurring revenue. The inclusion of AcademicWorks, JustGiving and Reeher also contributed to the increase in costs of recurring revenue during 2018 when compared to the same periods in 2017. The increase in amortization of software development costs was primarily due to investments made on innovation, quality and the integration of our cloud-based solutions. The increase in recurring gross margin when comparing 2018 to 2017 was primarily the result of the positive economics of new and migrating customers to our next generation cloud-based solutions and accretive recent business acquisitions, as growth in recurring revenue outpaced the growth in related costs.

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Blackbaud, Inc.

2017 vs. 2016

The increase in recurring revenue during 2017, when compared 2016, was primarily due to strong demand across our cloud-based solution portfolio as revenue from subscriptions increased $94.3 million. To a much lesser extent, the inclusion of AcademicWorks and JustGiving in 2017 contributed to the increase in subscriptions revenue. The favorable impact from subscriptions was partially offset by a decrease in maintenance revenue of $18.8 million, during 2017, when compared 2016, due to our efforts to migrate our existing customer base onto our cloud-based solutions, as discussed above.

The increase in cost of recurring during 2017, when compared to 2016, was driven primarily by increases in transaction-based costs of $19.0 million directly related to an increase in transactional revenue, costs of third-party technology embedded in certain of our subscription solutions of $7.4 million and amortization of software development costs of $4.3 million.

One-time services and other

								2016	
One-time services and other revenue	$86.4	(16.8	)%	$103.9		(15.2	)%	$122.6	
Cost of one-time services and other	76.3	(9.5	)%	84.3		(9.0	)%	92.6	
One-time services and other gross profit(1)	$10.2	(48.2	)%	$19.6		(34.6	)%	$30.0	
One-time services and other gross margin	11.8	%		18.9	%			24.5	%

(1) The individual amounts for each year may not sum to one-time services and other gross profit due to rounding.

One-time services and other revenue is comprised of fees for one-time consulting, analytic and onsite training services, as well as revenue from the sale of our software sold under perpetual license arrangements, fees from user conferences and third-party software referral fees.

Cost of one-time services and other is primarily comprised of compensation costs for professional services and onsite training personnel, other costs incurred in providing onsite customer training, third-party contractor expenses, data expense incurred to perform one-time analytic services, third-party software royalties, costs of user conferences, allocated depreciation, facilities and IT support costs and amortization of intangible assets from business combinations.

2018 vs. 2017

One-time services and other revenue decreased during 2018, when compared to 2017, primarily due to decreases in one-time consulting revenue of $8.3 million and analytics revenue of $6.0 million. We expect that the ongoing shift in our go-to-market strategy towards cloud-based subscription offerings, which generally include integrated analytics and require less implementation and customization services, will continue to negatively impact one-time services and other revenue. We are also selling more subscription-based contracts for professional services and services embedded in our renewable cloud-based solution contracts. In addition, we have also used promotions and discounts for our consulting services as incentives to accelerate the migration of our existing customer base from on-premises solutions toward our cloud-based subscriptions.

The decrease in cost of one-time services and other during 2018, when compared to 2017, was primarily due to decreases in compensation costs, which is in line with the ongoing shift in our go-to-market strategy as discussed above. Productivity gains during 2018 for our one-time services personnel also contributed to the decreases in cost of one-time services and other.

One-time services and other gross margin decreased during 2018, when compared to 2017, as the declines in higher margin analytics and license fees revenue associated with the shift in our go-to-market strategy outpaced the reductions in costs of one-time services and other discussed above. This is a trend we expect to continue in the near term as we complete the transition of our solution portfolio to a cloud-based subscription delivery model.

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Blackbaud, Inc.

2017 vs. 2016

One-time services and other revenue decreased during 2017, when compared to 2016, primarily due to a $10.6 million decrease in consulting revenue and, to a much lesser extent, declines in license fees revenue and analytics revenue. As previously disclosed, we expected the ongoing shift in our go-to-market strategy towards cloud-based subscription offerings to negatively impact one-time services and other revenue. We also used promotions and discounts for our consulting services as incentives to accelerate the migration of our existing customer base from on-premises solutions toward our cloud-based subscriptions. The maturation of our Blackbaud CRM solution lessened the extent of implementation services required for that solution. In addition, we increasingly sold our Blackbaud CRM solution as a subscription offering, which resulted in less license fees revenue.

The decrease in cost of one-time services and other during 2017, when compared to 2016, was primarily due to a decrease in compensation costs of $4.4 million, which was in line with the shift in our go-to-market strategy as discussed above.

One-time services and other gross margin decreased during 2017, when compared to 2016, primarily due to the declines in consulting, license fees and analytics revenue coupled with the more modest reductions in costs of one-time services and other.

Operating expenses

Sales, marketing and customer success

Sales, marketing and customer success expense	$192.8	13.7	%	$169.6	12.9	%	$150.2	
% of total revenue	22.7	%		21.5	%		20.5	%

Sales, marketing and customer success expense includes compensation costs, variable sales commissions, travel-related expenses, advertising and marketing materials, public relations costs and allocated depreciation, facilities and IT support costs.

2018 vs. 2017

We continue to make investments to drive sales effectiveness, which is a component of our four-point growth strategy. We also continue investing in our customer success organization to drive customer outcomes, loyalty, retention and referrals. The increases in sales, marketing and customer success expense in dollars and as a percentage of total revenue during 2018, when compared to 2017, was primarily due to increases in compensation costs of $9.7 million, commissions expense of $7.6 million, and advertising and marketing costs of $1.9 million. Compensation costs increased as a result of our efforts during the second half of 2018 to increase our direct sales force and we expect to continue making similar investments during 2019 and beyond. These incremental investments are intended to address the large market opportunity that we see for ourselves and fuel future revenue growth. In addition, compensation costs increased due to incremental headcount associated with the inclusion of AcademicWorks, JustGiving and Reeher. The increase in commission expense was primarily driven by an increase in commissionable sales. Advertising and marketing costs increased as a result of our inclusion of JustGiving.

2017 vs. 2016

The increases in sales, marketing and customer success expense in dollars and as a percentage of total revenue during 2017, when compared to 2016, were primarily due to an increase in compensation costs of $12.8 million. Also contributing to the increase in sales, marketing and customer success expense was an increase in commissions expense of $3.6

million. Compensation costs increased primarily due to incremental headcount associated with the increase in direct sales, marketing, and customer success efforts of our growing operations. The increase in commissions expense was primarily driven by an increase in commissionable sales.

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Blackbaud, Inc.

Research and development

					2016
Research and development expense[1]	$98.8	9.9 %	$89.9	— %	$89.9
% of total revenue	11.6 %		11.4 %		12.3 %

(1) Not included in research and development expense for 2018, 2017 and 2016 were $36.5 million, $28.0 million and $26.2 million, respectively, of qualifying costs associated with development activities that are required to be capitalized under the internal-use software accounting guidance such as those related to development of our next generation cloud-based solutions, as well as development costs associated with acquired companies. Qualifying capitalized software development costs associated with our cloud-based solutions are subsequently amortized to cost of subscriptions revenue over the related asset's estimated useful life, which generally range from three to seven years.

Research and development expense includes compensation costs for engineering and product management personnel, third-party contractor expenses, software development tools and other expenses related to developing new solutions or upgrading and enhancing existing solutions that do not qualify for capitalization, and allocated depreciation, facilities and IT support costs.

2018 vs. 2017

We continue to make investments to deliver integrated and open solutions in the cloud, which is a component of our four-point growth strategy. The increase in research and development expense dollars during 2018, when compared to 2017, was primarily due to an increase in compensation costs of $7.6 million and third-party contractor expenses of $6.3 million. The increases in compensation costs were primarily associated with the inclusion of JustGiving's and Reeher's engineering resources. The incremental third-party contractor expenses were intended to help drive our solution development efforts, including our new Cloud Solutions for Faith Communities and Higher Education and the Integrated Cloud Initiative for Nonprofits. The increase in research and development expense dollars was partially offset by an increase in the amount of software development costs that were required to be capitalized under the internal-use software guidance. Research and development expense as a percentage of total revenue remained relatively similar during both periods. We expect that the amount of software development costs capitalized will continue to increase modestly in the near-term as we make investments in innovation, quality and the integration of our solutions, which we believe will drive long-term revenue growth.

2017 vs. 2016

Research and development expense remained unchanged during 2017, when compared to 2016. During 2017, an increase in compensation costs of $1.3 million associated with our addition of specialized engineering resources to help drive our solution development efforts was offset primarily by an increase in the amount of software development costs that were capitalized of $1.9 million. As discussed above, the increase in the amount capitalized was a result of incurring more qualifying costs associated with development activities that are required to be capitalized under the internal-use software guidance.

Research and development expense decreased as a percentage of total revenue during 2017, when compared to 2016, primarily due to productivity gains, which have allowed us to scale our business. The increase in the amount of software development costs capitalized as discussed above also contributed to the decreases in research and development expense as a percentage of total revenue.

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Blackbaud, Inc.

General and administrative

					2016	
General and administrative expense	$106.4	12.1 %	$94.9	16.6 %	$81.3	
% of total revenue	12.5 %		12.0 %		11.1 %	

General and administrative expense consists primarily of compensation costs for general corporate functions, including senior management, finance, accounting, legal, human resources and corporate development, third-party professional fees, insurance, allocated depreciation, facilities and IT support costs, acquisition-related expenses and other administrative expenses.

2018 vs. 2017

The increase in general and administrative expense in dollars and as a percentage of total revenue during 2018, when compared to 2017, was primarily due to increases in compensation costs of $6.0 million and third-party contractor expenses of $2.6 million. The increase in compensation costs was driven by a combination of higher salaries and employee benefits, primarily related to the inclusion of JustGiving and Reeher personnel, and stock-based compensation. The increases in third-party contractor expenses and acquisition-related integration costs were primarily related to our recent business acquisitions.

2017 vs. 2016

The increase in general and administrative expense during 2017, when compared to 2016, was primarily due to increases in rent expense of $4.4 million and employee severance costs of $2.4 million. A net increase in acquisition-related expenses and integration costs of $5.2 million during 2017 also drove up general and administrative expense. The increase in rent expense was primarily driven by the end in the fourth quarter of 2016 of the South Carolina state incentive payments we received as a result of locating our former headquarters facility in Berkeley County, South Carolina. These amounts were recorded as a reduction of rent expense upon receipt. Also contributing to the increase in rent expense were new operating leases for equipment that we had historically purchased.

General and administrative expense as a percentage of total revenue increased during 2017, when compared to 2016, primarily due to the incremental acquisition-related costs and rent expense discussed above.

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Blackbaud, Inc.

Restructuring

During 2017, in an effort to further our organizational objectives including, improved operating efficiency, customer outcomes and employee satisfaction, we initiated a multi-year plan to consolidate and relocate some of our existing offices to highly modern and more collaborative workspaces with short-term financial commitments. These workspaces are also more centrally located for our employees and closer to our customers and prospects. Restructuring costs incurred to date and expected to be incurred consist primarily of costs to terminate existing lease agreements, contractual lease payments, net of estimated sublease income, upon vacating space as part of the plan, as well as insignificant costs to relocate affected employees and write-off leasehold improvement assets that we will no longer use. We currently expect to incur before-tax restructuring costs associated with these activities of between $8.5 million and $9.5 million, of which $5.4 million have been incurred through 2018. We expect that a significant portion of the remaining costs will be incurred in 2019. Our updated estimates reflect the more aggressive actions taken to relocate and consolidate some of our offices than we had originally anticipated. We also expect to incur employee severance costs related to the plan; however, these costs cannot be reasonably estimated at this time. These restructuring activities are currently expected to result in improved operating efficiencies and future annual before-tax savings of between $5.0 million and $6.0 million beginning in 2020.

The following table summarizes our facilities optimization restructuring costs as of December 31, 2018:

By component:		
Contract termination costs	$3,581	$4,176
Other costs	1,009	1,208
Total	$4,590	$5,384

The change in our liability related to our facilities optimization restructuring during the twelve months ended December 31, 2018, consisted of the following:

By component:				
Contract termination costs	$ 691	$3,581	$(2,407)	$1,865
Other costs	—	1,009	(959)	50
Total	$ 691	$4,590	$(3,366)	$1,915

Interest expense

					2016
Interest expense	$15.9	31.4 %	$12.1	14.3 %	$10.6
% of total revenue	1.9 %		1.5 %		1.4 %

2018 vs. 2017

Interest expense increased during 2018, when compared to 2017, primarily due to an increase in our average daily borrowings related to our acquisitions of JustGiving in October 2017 and Reeher in April 2018. Also contributing to the increase in interest expense were modest increases in our weighted average effective interest rates, driven by an increasing interest rate environment during 2017 and 2018. In the near term, we expect interest expense as well as interest expense as a percentage of revenue to increase as a result of our acquisition of YourCause in January 2019.

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Blackbaud, Inc.

2017 vs. 2016

Interest expense increased during 2017, when compared to 2016, primarily due to the required immediate expense recognition for certain debt issuance costs when we refinanced our credit facility in June 2017. Also contributing to the increase in interest expense during 2017 were modest increases in our weighted average effective interest rates, driven by an increasing interest rate environment during 2017.

Deferred revenue

The table below compares the components of deferred revenue from our consolidated balance sheets:

Recurring	Over the period billed in advance, generally one year	$ 287.0	8.1 %	$ 265.5
One-time services and other	As services are delivered	11.6	(12.1)%	13.2
Total deferred revenue[1]		298.6	7.1 %	278.7
Less: Long-term portion		2.6	(29.6)%	3.6
Current portion[1]		$ 296.0	7.6 %	$ 275.1

(1) The individual amounts for each year may not sum to total deferred revenue or current portion of deferred revenue due to rounding.

To the extent that our customers are billed for our solutions and services in advance of delivery, we record such amounts in deferred revenue. Our recurring revenue contracts are generally for a term of three years at contract inception with one to three-year renewals thereafter, billed annually in advance and non-cancelable. We generally invoice our customers with recurring revenue contracts in annual cycles 30 days prior to the end of the contract term.

Deferred revenue from recurring revenue contracts increased during 2018, primarily due to new subscription sales of our cloud-based solutions, and to a much lesser extent, the inclusion of Reeher. We also sold more subscription-based contracts for professional services and services embedded in our renewable cloud-based solution contracts, which we expect to continue.

Deferred revenue from one-time services and other decreased during 2018, primarily due to a decrease in one-time consulting and analytics sales. As discussed above, the decrease in sales of one-time services was expected as we continue to migrate our existing customers towards our cloud-based subscription offerings, which generally include integrated analytics and require less implementation and customization services.

We have acquired businesses whose net tangible assets include deferred revenue. In accordance with GAAP reporting requirements, we recorded write-downs of deferred revenue from customer arrangements predating the acquisition to fair value, which resulted in lower recorded deferred revenue as of the acquisition date than the actual amounts paid in advance for solutions and services under those customer arrangements. Therefore, our deferred revenue after an acquisition will not reflect the full amount of deferred revenue that would have been reported if the acquired deferred revenue was not written down to fair value. Further explanation of this impact is included below under the caption "Non-GAAP financial measures".

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Blackbaud, Inc.

Income tax provision

Our income tax provision and effective income tax rates, including the effects of period-specific events, were:

Income tax (benefit) provision	$(0.2)	$(15.3)	$11.9
Effective income tax rate	(0.5)%	(26.2)%	20.8 %

Our effective income tax rate may fluctuate quarterly as a result of factors, including changes in tax law in jurisdictions where we conduct business, transactions entered into, changes in the geographic distribution of our earnings or losses, and our assessment of certain tax contingencies and valuation allowances.

We have deferred tax assets for federal, state, and international net operating loss carryforwards and tax credits. The federal and state net operating loss carryforwards are subject to various Internal Revenue Code limitations and applicable state tax laws. A portion of the foreign and state net operating loss carryforwards and a portion of state tax credits have a valuation reserve due to the uncertainty of realizing such carryforwards and credits in the future.

We file income tax returns in the U.S. for federal and various state jurisdictions as well as in foreign jurisdictions including Canada, the United Kingdom, Australia, Ireland and Costa Rica. We are generally subject to U.S. federal income tax examination for calendar tax years ending 2015 through 2018, as well as state and foreign income tax examinations for various years depending on statute of limitations of those jurisdictions.

We have taken federal and state tax positions for which it is reasonably possible that the total amount of unrecognized tax benefits may decrease within the next twelve months. The possible decrease could result from the expiration of statutes of limitations. The reasonably possible decrease at December 31, 2018 was $1.4 million.

We recognize accrued interest and penalties, if any, related to unrecognized tax benefits as a component of income tax expense.

2018 vs. 2017

The increase in our effective income tax rate during 2018, when compared to 2017, was primarily due to the effect of U.S. tax reform legislation signed into law on December 22, 2017 (see Note 12 of our consolidated financial statements in this report for additional details). Our effective income tax rate in 2017 included the benefit attributable to the revaluation of our U.S. deferred tax assets and liabilities as of December 31, 2017, resulting from the reduced U.S. corporate federal income tax rate effective for tax years beginning after that date.

The increase in our effective income tax rate was partially offset by the impact of the benefit to income tax expense relating to stock-based compensation items, calculated prior to the impact of the U.S. federal corporate tax rate change as a result of the Tax Act. This favorable impact was attributable to an increase in the market price for shares of our common stock, as reported by Nasdaq, as well as an increase in the number of stock awards that vested and were exercised. The benefit to income tax expense relating to stock-based compensation during 2018 was reduced as a result of a decrease in the U.S. corporate tax rate.

The increase in our effective income tax rate was also partially offset by the impact of the lower U.S. federal corporate tax rate on pre-tax income and the release of our tax reserve due to the expiration of the federal statute of limitations for 2014.

In 2019, we expect that our effective income tax rate will increase due to a decrease in the benefit to income tax expense relating to stock-based compensation items. The unfavorable expected impact is attributable to a decrease in the market price for shares of our common stock, as reported by Nasdaq.

The total amount of unrecognized tax benefit that, if recognized, would favorably affect the effective income tax rate, was $3.3 million and $4.6 million at December 31, 2018 and December 31, 2017, respectively.

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2017 vs. 2016

The decrease in our effective income tax rate during 2017 when compared to 2016 was primarily due to the effect of U.S. tax reform legislation signed into law on December 22, 2017 (see Note 12 of our consolidated financial statements in this report for additional details). The $20.0 million discrete tax benefit to expense is attributable to the revaluation of the ending U.S. deferred tax assets and liabilities resulting from the reduced U.S. corporate federal income tax rate from 35% to 21% effective for tax years beginning after December 31, 2017.

The decrease in our effective income tax rate during 2017 when compared to 2016 was also attributable to a $12.5 million discrete tax benefit to expense relating to stock-based compensation items, as compared to a $7.7 million discrete tax benefit in 2016. The increase in the discrete tax benefit in 2017 relating to stock-based compensation was attributable to an increase in the market price for shares of our common stock, as reported by Nasdaq, as well as an increase in the number of stock awards that vested and were exercised. Most of our equity awards are granted during our first quarter and vest in subsequent years during the same quarter.

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Non-GAAP financial measures

The operating results analyzed below are presented on a non-GAAP basis. We use non-GAAP revenue, non-GAAP gross profit, non-GAAP gross margin, non-GAAP income from operations, non-GAAP operating margin, non-GAAP net income and non-GAAP diluted earnings per share internally in analyzing our operational performance. Accordingly, we believe these non-GAAP measures are useful to investors, as a supplement to GAAP measures, in evaluating our ongoing operational performance. While we believe these non-GAAP measures provide useful supplemental information, non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. In addition, these non-GAAP financial measures may not be completely comparable to similarly titled measures of other companies due to potential differences in the exact method of calculation between companies.

We have acquired businesses whose net tangible assets include deferred revenue. In accordance with GAAP reporting requirements, we recorded write-downs of deferred revenue under arrangements predating the acquisition to fair value, which resulted in lower recognized revenue than the contributed purchase price until the related obligations to provide services under such arrangements are fulfilled. Therefore, our GAAP revenues after the acquisitions will not reflect the full amount of revenue that would have been reported if the acquired deferred revenue was not written down to fair value. The non-GAAP measures described below reverse the acquisition-related deferred revenue write-downs so that the full amount of revenue booked by the acquired companies is included, which we believe provides a more accurate representation of a revenue run-rate in a given period and, therefore, will provide more meaningful comparative results in future periods.

The non-GAAP financial measures discussed below exclude the impact of certain transactions because we believe they are not directly related to our operating performance in any particular period, but are for our long-term benefit over multiple periods. We believe that these non-GAAP financial measures reflect our ongoing business in a manner that allows for meaningful period-to-period comparisons and analysis of trends in our business.

GAAP Revenue	$848.6	7.6 %	$788.5	7.8 %	$731.6	
Non-GAAP adjustments:						
Add: Acquisition-related deferred revenue write-down	2.4	(3.5)%	2.5	(31.4)%	3.6	
Non-GAAP revenue(1)	$851.0	7.6 %	$791.0	7.6 %	$735.3	
GAAP gross profit	$466.9	9.4 %	$426.6	8.7 %	$392.4	
GAAP gross margin	55.0 %		54.1 %		53.6	%
Non-GAAP adjustments:						
Add: Acquisition-related deferred revenue write-down	2.4	(3.5)%	2.5	(31.4)%	3.6	
Add: Stock-based compensation expense	5.2	51.1 %	3.5	5.2 %	3.3	
Add: Amortization of intangibles from business combinations	42.2	5.3 %	40.1	1.4 %	39.6	
Add: Employee severance	0.9	(7.6)%	1.0	160.2 %	0.4	
Add: Acquisition-related integration costs	—	(70.9)%	0.1	100.0 %	—	
Subtotal(1)	50.8	7.8 %	47.1	0.6 %	46.9	

Non-GAAP gross profit[(1)]	$	517.7	9.3	%	$	473.7	7.8	%	$	439.3
Non-GAAP gross margin		60.8	%			59.9	%			59.7 %

(1) The individual amounts for each year may not sum to non-GAAP revenue, subtotal or non-GAAP gross profit due to rounding.

Blackbaud, Inc.

GAAP income from operations	$ 59.4	(12.9)%	$ 68.2	(0.1)%	$ 68.2
GAAP operating margin	7.0%		8.6%		9.3%
Non-GAAP adjustments:					
Add: Acquisition-related deferred revenue write-down	2.4	(3.5)%	2.5	(31.4)%	3.6
Add: Stock-based compensation expense	48.3	18.8%	40.6	24.5%	32.6
Add: Amortization of intangibles from business combinations	47.1	8.5%	43.4	2.3%	42.4
Add: Employee severance	2.2	(48.3)%	4.3	117.8%	2.0
Add: Acquisition-related integration costs	3.7	281.3%	1.0	(31.9)%	1.4
Add: Acquisition-related expenses	2.8	(51.9)%	5.9	1,864.8%	0.3
Add: Restructuring costs	4.6	478.1%	0.8	100.0%	—
Subtotal(1)	111.1	12.8%	98.5	19.6%	82.4
Non-GAAP income from operations(1)	$ 170.5	2.3%	$ 166.7	10.7%	$ 150.6
Non-GAAP operating margin	20.0%		21.1%		20.5%
GAAP income before provision for income taxes	$ 44.6	(23.5)%	$ 58.3	1.7%	$ 57.4
GAAP net income	$ 44.8	(39.1)%	$ 73.6	62.2%	$ 45.4
Shares used in computing GAAP diluted earnings per share	48,045,080	0.6%	47,775,702	1.0%	47,316,538
GAAP diluted earnings per share	$ 0.93	(39.6)%	$ 1.54	60.4%	$ 0.96
Non-GAAP adjustments:					
Add: GAAP income tax (benefit) provision	(0.2)	(98.6)%	(15.3)	(228.0)%	11.9
Add: Total Non-GAAP adjustments affecting loss from operations	111.1	12.8%	98.5	19.6%	82.4
Less: Gain on derivative instrument	—	(100.0)%	(0.5)	100.0%	—
Add: Loss on debt extinguishment	—	(100.0)%	0.3	100.0%	—
Non-GAAP income before provision for income taxes	155.7	(0.6)%	156.7	12.1%	139.7
Assumed non-GAAP income tax provision(2)	31.1	(37.9)%	50.1	12.1%	44.7
Non-GAAP net income(1)	$ 124.6	16.9%	$ 106.6	12.1%	$ 95.0
Shares used in computing Non-GAAP diluted earnings per share	48,045,080	0.6%	47,775,702	1.0%	47,316,538
Non-GAAP diluted earnings per share	$ 2.59	16.1%	$ 2.23	10.9%	$ 2.01

(1) The individual amounts for each year may not sum to subtotal, non-GAAP income from operations, non-GAAP income before provision for income taxes or non-GAAP net income due to rounding.

(2) Beginning in 2018, we now apply a non-GAAP effective tax rate of 20.0% in our determination of non-GAAP net income, which represents the GAAP effective tax rate, excluding the discrete tax effect of stock-based compensation. For the years ended December 31, 2017 and 2016, we applied a non-GAAP effective tax rate of 32.0% in our determination of non-GAAP net income.

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Non-GAAP free cash flow is defined as operating cash flow less capital expenditures, including costs required to be capitalized for software development, and capital expenditures for property and equipment.

GAAP net cash provided by operating activities	$201.4	14.2 %	$176.3	14.8 %	$153.6
Less: purchase of property and equipment	(14.7)	44.2 %	(10.2)	(42.3)%	(17.7)
Less: capitalized software development costs	(37.6)	32.8 %	(28.3)	7.5 %	(26.4)
Non-GAAP free cash flow	$149.0	8.2 %	$137.7	25.7 %	$109.6

Non-GAAP organic revenue growth

In addition, we use non-GAAP organic revenue growth, non-GAAP organic revenue growth on a constant currency basis and non-GAAP organic recurring revenue growth, in analyzing our operating performance. We believe that these non-GAAP measures are useful to investors, as a supplement to GAAP measures, for evaluating the periodic growth of our business on a consistent basis. Each of these measures of non-GAAP organic revenue growth excludes incremental acquisition-related revenue attributable to companies acquired in the current fiscal year. For companies, if any, acquired in the immediately preceding fiscal year, each of these non-GAAP organic revenue growth measures reflects presentation of full year incremental non-GAAP revenue derived from such companies as if they were combined throughout the prior period, and they include the non-GAAP revenue attributable to those companies, as if there were no acquisition-related write-downs of acquired deferred revenue to fair value as required by GAAP. In addition, each of these non-GAAP organic revenue growth measures excludes prior period revenue associated with divested businesses. The exclusion of the prior period revenue is to present the results of the divested businesses within the results of the combined company for the same period of time in both the prior and current periods. We believe this presentation provides a more comparable representation of its current business' organic revenue growth and revenue run-rate.

2018

GAAP revenue	**$848.6**	**7.6 %**	**$788.5**
(Less) Add: Non-GAAP acquisition-related revenue [(1)]	(4.9)		32.8
Total Non-GAAP adjustments	(4.9)		32.8
Non-GAAP organic revenue [(2)]	**$843.7**	**2.7 %**	**$821.3**
Foreign currency impact on Non-GAAP organic revenue [(3)]	(2.4)		—
Non-GAAP organic revenue on constant currency basis [(3)]	**$841.3**	**2.4 %**	**$821.3**
GAAP recurring revenue	**$762.2**	**11.3 %**	**$684.6**
(Less) Add: Non-GAAP acquisition-related revenue [(1)]	(4.8)		32.5
Total Non-GAAP adjustments	(4.8)		32.5
Non-GAAP organic recurring revenue	**$757.4**	**5.6 %**	**$717.1**

(1) Non-GAAP acquisition-related revenue excludes incremental acquisition-related revenue calculated in accordance with GAAP that is attributable to companies acquired in the current fiscal year. For companies acquired in the immediately preceding fiscal year, non-GAAP acquisition-related revenue reflects presentation of full-year incremental non-GAAP revenue derived from such companies, as if they were combined throughout the prior period, and it includes the current period non-GAAP revenue from the acquisition-related deferred revenue write-down attributable to those companies.

(2) Non-GAAP organic revenue for the prior year periods presented herein will not agree to non-GAAP organic revenue presented in the respective prior period quarterly financial information solely due to the manner in which non-GAAP organic revenue

growth is calculated.

(3) To determine non-GAAP organic revenue growth on a constant currency basis, revenues from entities reporting in foreign currencies were translated to U.S. Dollars using the comparable prior period's quarterly weighted average foreign currency exchange rates. The primary foreign currencies creating the impact are the Canadian Dollar, EURO, British Pound and Australian Dollar.

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Seasonality

Our revenues normally fluctuate as a result of certain seasonal variations in our business. Our transaction revenue has historically been at its lowest in the first quarter due to the timing of customer fundraising initiatives and events. Our revenue from payment processing services has historically increased during the fourth quarter due to year-end giving. Our revenue from professional services has historically been lower in the first quarter when many of those services commence and in the fourth quarter due to the holiday season. As a result of these and other factors, our total revenue has historically been lower in the first quarter than in the remainder of our fiscal year, with the fourth quarter historically achieving the highest total revenue. Our expenses, however, do not vary significantly as a result of these factors, but do fluctuate on a quarterly basis due to varying timing of expenditures. Our cash flow from operations normally fluctuates quarterly due to the combination of the timing of customer contract renewals including renewals associated with customers of acquired companies, delivery of professional services and occurrence of customer events, the payment of bonuses, as well as merit-based salary increases, among other factors. Historically, due to lower revenues in our first quarter, combined with the payment of bonuses from the prior year in our first quarter, our cash flow from operations has been lowest in our first quarter, and due to the timing of customer contract renewals, many of which take place at or near the beginning of our third quarter, our cash flow from operations has been lower in our second quarter as compared to our third and fourth quarters. Partially offsetting these favorable drivers of cash flow from operations in our third and fourth quarters are merit-based salary increases, which are generally effective in April each year. In addition, deferred revenues can vary on a seasonal basis for the same reasons. These patterns may change as a result of the continued shift to online giving, growth in volume of transactions for which we process payments, or as a result of acquisitions, new market opportunities, new solution introductions or other factors. Our cash flow from financing is negatively impacted in our first quarter when most of our equity awards vest, as we pay taxes on behalf of our employees related to the settlement or exercise of equity awards.

Liquidity and Capital Resources

The following table presents selected financial information about our financial position:

Cash and cash equivalents	$ 30.9	3.5 %	$ 29.8
Property and equipment, net	40.0	(5.2)%	42.2
Software development costs, net	75.1	38.8 %	54.1
Total carrying value of debt	387.1	(11.7)%	438.2
Working capital	(207.7)	(18.5)%	(175.2)

The following table presents selected financial information about our cash flows:

Net cash provided by operating activities	$201.4	14.2 %	$176.3	14.8 %	$153.6
Net cash used in investing activities	(97.8)	(47.1)%	(184.9)	289.8 %	(47.4)
Net cash (used in) provided by financing activities	(291.9)	(204.8)%	278.6	(3,360.5)%	(8.5)

Our principal sources of liquidity are operating cash flow, funds available under the 2017 Credit Facility and cash on hand. Our operating cash flow depends on continued customer renewal of our subscription and maintenance arrangements and market acceptance of our solutions and services. Based on current estimates of revenue and expenses, we believe that the currently available sources of funds and anticipated cash flows from operations will be adequate for at least the next twelve months to finance our operations, fund anticipated capital expenditures, meet our debt obligations and pay dividends. Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to declare and pay further dividends and/or repurchase our common stock. To the extent we undertake future material acquisitions, investments or unanticipated capital expenditures, we may require additional capital. In that context, we regularly evaluate opportunities to enhance our capital structure including through potential debt or equity issuances.

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Blackbaud, Inc.

At December 31, 2018, our total cash and cash equivalents balance included approximately $13.8 million of cash that was held outside the U.S. While these funds may not be needed to fund our U.S. operations for at least the next twelve months, if we need these funds, we may be required to accrue and pay taxes to repatriate a portion of the funds. We currently do not intend nor anticipate a need to repatriate our cash held outside the U.S.

Operating cash flow

Throughout 2018, 2017 and 2016, our cash flows from operations were derived principally from: (i) our earnings from on-going operations prior to non-cash expenses such as depreciation, amortization, stock-based compensation, loss on sale of business, impairment of capitalized software development costs, amortization of deferred financing costs and debt discount and adjustments to our provision for sales returns and allowances; and (ii) changes in our working capital.

Working capital changes are composed of changes in accounts receivable, prepaid expenses and other assets, trade accounts payable, accrued expenses and other liabilities and deferred revenue.

2018 vs. 2017

Cash flow from operations associated with working capital increased $30.7 million during 2018 when compared to 2017, primarily due to:

- an increase in the collection of customer account balances;
- a decrease in prepaid taxes; and
- the timing of vendor payments.

2017 vs. 2016

Cash flow from operations associated with working capital decreased $3.0 million during 2017 when compared to 2016, primarily due to:

- an increase in prepaid taxes during 2017 related to tax planning; partially offset by
- a decrease in bonus payments.

Investing cash flow

During 2019, we expect our total capital expenditures to be relatively consistent with 2018, which includes purchases of property and equipment and estimated cash outlays for capitalized software development costs. Refer to the commitments and contingencies subsection below for future minimum commitments related to purchase obligations.

2018 vs. 2017

Net cash used in investing activities of $97.8 million decreased by $87.1 million during 2018, when compared to 2017.

During 2018, we used net cash of $44.9 million, primarily for our acquisition of Reeher, while we spent $146.8 million on investments in acquired companies in 2017. We used $37.6 million of cash for software development costs, which was up $9.3 million from cash spent during 2017. The increase in cash outlays for software development costs was primarily driven by development activities related to our cloud-based solutions as well as development activities for Blackbaud SKY, our modern cloud platform.

We also spent $14.7 million of cash for purchases of property and equipment during 2018, which was up $4.5 million from cash spent in 2017. The increase in cash outlays for property and equipment was primarily driven by leasehold improvements for our New Headquarters Facility in Charleston, South Carolina.

Blackbaud, Inc.

2017 vs. 2016

Net cash used in investing activities of $184.9 million increased by $137.5 million during 2017, when compared to 2016.

During 2017, we used net cash of $146.8 million for the acquisitions of AcademicWorks and JustGiving compared to $3.4 million spent on investments in acquired companies in 2016. We used $28.3 million of cash for software development costs, which was up modestly from cash spent during 2016, as we continued making investments in innovation, quality and the integration of our solutions cloud-based solutions.

We also spent $10.2 million of cash for purchases of property and equipment during 2017, which was down $7.5 million from cash spent in 2016. The decrease in cash outlays for property and equipment was primarily driven by a shift toward leasing certain equipment that we had historically purchased.

Financing cash flow

2018 vs. 2017

During 2018, we had a net decrease in borrowings of $51.6 million, even with the incremental borrowings needed to finance our acquisition of Reeher, compared to a net increase in borrowings of $95.4 million in 2017.

We paid $27.7 million to satisfy tax obligations of employees upon settlement or exercise of equity awards during 2018 compared to $24.0 million during 2017. The amount of taxes paid by us on the behalf of employees related to the settlement or exercise of equity awards varies from period to period based upon the timing of grants and vesting, employee exercise decisions, as well as the market price for shares of our common stock at the time of settlement. Due to a change in the timing of our annual equity award grants, most of our equity awards now vest in our first quarter. In addition, during 2017, we paid dividends of $23.3 million, which was relatively consistent with 2017.

Cash flow from financing activities associated with changes in restricted cash due to customers decreased $415.2 million during 2018 when compared to 2017, as the amount of restricted cash held and payable by us to customers as of December 31, 2017 was significantly larger than at the same date in 2016.

2017 vs. 2016

During 2017, we had a net increase in borrowings of $95.4 million, which was used to finance our acquisition of JustGiving, compared to a net decrease in borrowings of $66.4 million in 2016. We also paid $3.1 million in financing costs as a result of refinancing our credit facility.

We paid $24.0 million to satisfy tax obligations of employees upon settlement or exercise of equity awards during 2017 compared to $15.4 million during 2016. In addition, during 2017, we paid dividends of $23.1 million, which was relatively consistent with 2016.

Cash flow from financing activities associated with changes in restricted cash due to customers increased $130.7 million during 2017 when compared to 2016.

2017 Credit Facility

In June 2017, we entered into a five-year $700.0 million senior credit facility (the "2017 Credit Facility). Upon closing, we drew $300.0 million on a term loan and $110.0 million in revolving credit loans, which was used to repay all amounts outstanding under our previous credit facility and for other general corporate purposes.

We have drawn on our credit facility from time to time to help us meet financial needs, such as financing for business acquisitions. At December 31, 2018, our available borrowing capacity under the 2017 Credit Facility was $296.2 million. The 2017 Credit Facility matures in June 2022.

At December 31, 2018, the carrying amount of our debt under the 2017 Credit Facility was $387.1 million. Our average daily borrowings were $446.3 million during 2018.

Blackbaud, Inc.

Following is a summary of the financial covenants under our credit facility:

		Ratio as of December 31, 2018
Net Leverage Ratio	≤ 3.50 to 1.00	1.87 to 1.00
Interest Coverage Ratio	≥ 2.50 to 1.00	12.04 to 1.00

Under the 2017 Credit Facility, we also have restrictions on our ability to declare and pay dividends and our ability to repurchase shares of our common stock. In order to pay any cash dividends and/or repurchase shares of stock: (i) no default or event of default shall have occurred and be continuing under the 2017 Credit Facility, and (ii) our pro forma net leverage ratio, as set forth in the 2017 Credit Facility, must be 0.25 less than the net leverage ratio requirement at the time of dividend declaration or share repurchase. At December 31, 2018, we were in compliance with our debt covenants under the 2017 Credit Facility.

YourCause acquisition

In January 2019, we acquired YourCause for $157.0 million in cash, subject to certain adjustments set forth in the agreement and plan of merger. On January 2, 2019, we drew down a revolving credit loan under the 2017 Credit Facility to finance the acquisition.

Commitments and contingencies

As of December 31, 2018, we had contractual obligations with future minimum commitments as follows:

Recorded contractual obligations:					
Debt[1]	$388.8	$7.5	$15.0	$366.3	$—
Unrecorded contractual obligations:					
Operating leases[2]	178.1	24.3	41.7	30.2	81.9
Interest payments on debt[3]	47.8	14.1	27.7	6.0	—
Purchase obligations[4]	109.9	40.2	61.7	8.1	—
Total contractual obligations	$724.7	$86.1	$146.3	$410.5	$81.9

(1) Represents principal payments only, under the following assumptions: (i) that the amounts outstanding under the 2017 Credit Facility and our other debt at December 31, 2018 will remain outstanding until maturity, with minimum payments occurring as currently scheduled, and (ii) that there are no assumed future borrowings on the 2017 Revolving Facility for the purposes of determining minimum commitment amounts.

(2) Our commitments related to operating leases have not been reduced by incentive payments and reimbursement of leasehold improvements.

(3) The actual interest expense recognized in our consolidated statements of comprehensive income will depend on the amount of debt, the length of time the debt is outstanding and the interest rate, which could be different from our assumptions described in (1) above.

(4) We have contractual obligations for third-party technology used in our solutions and for other service we purchase as part of our normal operations. In certain cases, these arrangements require a minimum annual purchase commitment by us.

The term loan under the 2017 Credit Facility and our other debt require periodic principal payments. The balance of the term loans and any amounts drawn on the revolving credit loans are due upon maturity of the 2017 Credit Facility in June 2022.

The total liability for uncertain tax positions as of December 31, 2018 and December 31, 2017, was $3.7 million and $5.2 million, respectively. Our accrued interest and penalties related to tax positions taken on our tax returns was $0.7 million and $0.8 million as of December 31, 2018 and 2017, respectively.

In February 2019, our Board of Directors approved our annual dividend rate of $0.48 per share to be made in quarterly payments. Dividends at this annual rate would aggregate to $23.5 million assuming 49.0 million shares of common stock are outstanding, although dividends are not guaranteed and our Board of Directors may decide, in its absolute discretion, to change or suspend dividend payments at any time for any reason. Our ability to continue to declare and pay dividends quarterly this year and beyond might be restricted by, among other things, the terms of the 2017 Credit Facility, general economic conditions and our ability to generate adequate operating cash flow.

On February 6, 2019, our Board of Directors declared a first quarter dividend of $0.12 per share payable on March 15, 2019 to stockholders of record on February 27, 2019.

Off-Balance Sheet Arrangements

As of December 31, 2018, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have, a current or future effect on our financial condition, changes in our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Foreign Currency Exchange Rates

Approximately 14% of our total revenue for 2018 was generated by operations outside the United States. We do not have significant operations in countries in which the economy is considered to be highly inflationary. Our consolidated financial statements are denominated in U.S. dollars and, accordingly, changes in the exchange rate between foreign currencies and the U.S. dollar will affect the translation of our subsidiaries' financial results into U.S. dollars for purposes of reporting our consolidated financial results. The accumulated currency translation adjustment, recorded within other comprehensive loss as a component of stockholders' equity, was a loss of $6.6 million and $1.4 million as of December 31, 2018 and December 31, 2017, respectively.

The vast majority of our contracts are entered into by our U.S. or U.K. entities. The contracts entered into by the U.S. entity are almost always denominated in U.S. dollars or Canadian dollars, and contracts entered into by our U.K., Australian and Irish subsidiaries are generally denominated in British Pounds, Australian dollars and Euros, respectively. Historically, as the U.S. dollar weakened, foreign currency translation resulted in an increase in our revenues and expenses denominated in non-U.S. currencies. Conversely, as the U.S. dollar strengthened, foreign currency translation resulted in a decrease in our revenues and expenses denominated in non-U.S. currencies. During 2018, foreign translation resulted in an increase in our revenues and expenses denominated in non-U.S. currencies. Though we have exposure to fluctuations in currency exchange rates, the impact has generally not been material to our consolidated results of operations or financial position. During 2018, the fluctuation in foreign currency exchange rates increased our total revenue by $2.3 million and our income from operations by an insignificant amount. We will continue monitoring such exposure and take action as appropriate. To determine the impacts on revenue (or income from operations) from fluctuations in currency exchange rates, current period revenues (or income from operations) from entities reporting in foreign currencies were translated into U.S. dollars using the comparable prior year period's weighted average foreign currency exchange rates. These impacts are non-GAAP financial information and are not in accordance with, or an alternative to, information prepared in accordance with GAAP.

Inflation

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations. In addition, if inflationary pressures impact the rate of giving to our customers, there could be adverse impacts to our business, financial condition and results of operations.

Blackbaud, Inc.

Critical Accounting Estimates

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, we reconsider and evaluate our estimates and assumptions.

We base our estimates on historical experience, current trends and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could materially differ from any of our estimates under different assumptions or conditions. Our significant accounting policies are discussed in Note 2 of our consolidated financial statements in this report. We believe the accounting estimates listed below are the most critical to aid in fully understanding and evaluating our reported financial results, and they require our most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain.

Revenue Recognition

See Note 2 to our consolidated financial statements in this report for a complete discussion of our revenue recognition policies. Revenues are recognized when control of our services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services. We determine revenue recognition through the following steps: (1) Identification of the contract, or contracts, with a customer; (2) Identification of the performance obligations in the contract; (3) Determination of the transaction price; (4) Allocation of the transaction price to the performance obligations in the contract; and (5) Recognition of revenue when, or as, we satisfy a performance obligation.	Our revenue recognition accounting methodology contains uncertainties because it requires us to make significant estimates and assumptions, and to apply judgment. For example, for arrangements that have multiple performance obligations, we must exercise judgment and use estimates in order to (1) determine whether performance obligations are distinct and should be accounted for separately; (2) determine the standalone selling price of each performance obligation; (3) allocate the transaction price among the various performance obligations on a relative standalone selling price basis; and (4) determine whether revenue for each performance obligation should be recognized at a point in time or over time. In addition, we exercise judgment in certain transactions when determining whether we should recognize revenue based on the gross amount billed to a customer (as a principal) or the net amount retained (as an agent). These judgments are based on our determination of whether or not we control the service before it is transferred to the customer.	If we were to change any of these judgments or estimates, it could cause a material increase or decrease in the amount of revenue or deferred revenue that we report in a particular period.

Costs of Obtaining Contracts

We pay sales commissions at the time contracts with customers are signed or shortly thereafter, depending on the size and duration of the sales contract. Sales commissions and related fringe benefits earned by our sales force are considered incremental and recoverable costs of obtaining a contract with a customer. These costs are deferred and then amortized in a manner that aligns with the expected period of benefit, which we have determined to be five years. We do not generally pay commissions for contract renewals. The related amortization expense is included in sales, marketing and customer success expense in our consolidated statements of comprehensive income.	Our accounting methodology for determining the period over which we amortize costs of obtaining contracts with customers contains uncertainties because it requires us to make significant estimates and assumptions, and to apply judgment. For example, we must exercise judgment and use estimates in order to determine the expected period of benefit of our sales commissions. We take into consideration our customer contracts, including renewals, retention, our technology and other factors.	If we were to change any of these judgments or estimates, it could cause a material increase or decrease in the amount of assets, operating expenses or income that we report in a particular period.

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Blackbaud, Inc.

Business Combinations

We allocate the purchase price of an acquired business to its identifiable assets acquired and liabilities assumed at the acquisition date based upon their estimated fair values. The excess of the purchase price over the amount allocated to the assets acquired and liabilities assumed, if any, is recorded as goodwill.
We use available information to estimate fair values. We typically engage outside appraisal firms to assist in the fair value determination of long-lived and identifiable intangible assets, and any other significant assets or liabilities. We adjust the preliminary purchase price allocation, as necessary, up to one year after the acquisition closing date as we obtain new information about facts and circumstances that existed as of the closing date.

Our purchase price allocation methodology contains uncertainties because it requires us to make significant estimates and assumptions, and to apply judgment to estimate the fair value of assets acquired and liabilities assumed, especially with respect to long-lived and intangible assets.
Management estimates the fair value of assets acquired and liabilities assumed based on quoted market prices, the carrying value of the acquired assets and widely accepted valuation techniques, including discounted cash flows and market multiple analyses.
Critical estimates in valuing intangible assets include, but are not limited to, estimates about: future expected cash flows from customer contracts and relationships, proprietary technology and non-compete agreements; the acquired company's brand awareness and market position, the market awareness of the acquired company's branded technology solutions and services, assumptions about the period of time the brands will continue to be valuable; as well as expected costs to develop any in-process research and development into commercially viable solutions and estimated cash flows from the projects when completed, and discount rates. Our estimates of fair value are based upon assumptions we believe to be reasonable, but which are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and unanticipated events and circumstances may occur.

If actual results are materially different than the assumptions we used to determine fair value of the assets acquired and liabilities assumed through a business combination as well as the estimated useful lives of the acquired intangible assets, it is possible that adjustments to the carrying values of such assets and liabilities will have a material impact on our financial position and results of operations.
See Note 3 to our consolidated financial statements in this report for information regarding our business acquisitions.

Income Taxes

We make estimates and judgments in accounting for income taxes. Our income tax returns, like those of most companies, are periodically audited by domestic and foreign tax authorities.
We measure and recognize uncertain tax positions. To recognize uncertain tax positions, we must first determine if it is more likely than not that the position will be sustained upon audit. We must then measure the benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.
We make estimates in determining tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial reporting purposes. We record valuation allowances to reduce our deferred tax assets to the amount expected to be realized.

The calculation of our income tax provision requires estimates due to transactions, credits and calculations where the ultimate tax determination is uncertain. Uncertainties arise as a consequence of the actual source of taxable income between domestic and foreign locations, the outcome of tax audits and the ultimate utilization of tax credits.
Our effective income tax rate is also affected by changes in the geographic distribution of our earnings or losses, changes in tax law in jurisdictions where we conduct business.
Significant judgment is required in the identification and measurement of uncertain tax positions. Our liability for unrecognized tax benefits contains uncertainties because management is required to make assumptions and to apply judgment to estimate the exposures associated with our various filing positions.
In assessing the adequacy of a recorded valuation allowance significant judgment is required. We consider all positive and negative evidence and a variety of factors including the scheduled reversal of deferred tax liabilities, historical and projected future taxable income, and prudent and feasible tax planning strategies.

Although we believe that the judgments and estimates discussed herein are reasonable, actual results could differ, and we may be exposed to losses or gains that could be material.
To the extent actual results differ from estimated amounts recorded, such differences will impact the income tax provision in the period in which the determination is made.
If we determine there is less than a 50% likelihood that we will be able to use a deferred tax asset in the future in excess of its net carrying value, then an adjustment to the deferred tax asset valuation allowance is made to increase income tax expense, thereby reducing net income in the period such determination was made.

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Blackbaud, Inc.

Long-lived and Intangible Assets including Goodwill

We review our long-lived and finite-lived identifiable intangible assets for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. If such events or changes in circumstances occur, we use the undiscounted cash flow method to determine whether our long-lived and finite-lived intangible assets are impaired. To the extent that the carrying value of the asset exceeds the undiscounted cash flows over the estimated remaining life of the asset, we measure the impairment using discounted cash flows.

We test goodwill for impairment at the reporting unit level annually during our fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. We had one reporting unit for our fourth quarter 2018 and 2017 assessments (see Note 2 to our consolidated financial statements in this report).

We have the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. To the extent the qualitative factors indicate that the fair value is likely less than the carrying amount, we compare the fair value of the reporting unit with its carrying amount.

If more than one reporting unit is identified, we estimate fair value for each reporting unit based on projected future cash flows discounted using our weighted average cost of capital. If a single reporting unit is identified, we estimate fair value using market-based methods including the use of market capitalization and consideration of a control premium. In either case, if the carrying amount exceeds its fair value, an impairment loss is recorded for the excess.

When measuring impairment of an asset using discounted cash flows, we make assumptions and apply judgment in estimating future cash flows and asset fair values, including annual revenue growth rates, a terminal year growth rate and selecting a discount rate that reflects the risk inherent in future cash flows.

When the optional qualitative assessment of goodwill impairment is performed, significant judgment is required in the assessment of qualitative factors including but not limited to an evaluation of macroeconomic conditions as they relate to our business, industry and market trends, as well as the overall future financial performance of our reporting units and future opportunities in the markets in which they operate.

When using projected future cash flows for the quantitative goodwill impairment test, a number of significant assumptions and estimates are involved in estimating the fair value of each reporting unit, including revenue growth rates, operating margins, capital spending, discount rate, and working capital changes. Additionally, we make certain judgments and assumptions in allocating assets and liabilities to determine the carrying values for each of our reporting units.

We have not made any material changes in the accounting methodology we use to assess impairment loss during the years ended December 31, 2018, 2017 and 2016, except for the use of market-based methods, including the use of market capitalization to estimate the fair value of our one reporting unit in beginning in the fourth quarter of 2017.

No impairments to our long-lived and intangible assets including goodwill occurred during the years ended December 31, 2018, 2017 and 2016.

We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to assess impairment losses. However, if actual results are not consistent with our estimates or assumptions, we may be exposed to an impairment charge that could materially adversely impact our consolidated financial position and results of operations.

In order to evaluate the sensitivity of any quantitative fair value calculations on our most recent goodwill impairment test, a hypothetical 10% decrease to the fair value of our one reporting unit was calculated. This hypothetical 10% decrease would still result in excess fair value over carrying value for the reporting unit as of October 1, 2018.

Recently Issued Accounting Pronouncements

For a discussion of the impact that recently issued accounting pronouncements are expected to have on our financial position and results of operations when adopted in the future, see Note 2 of our consolidated financial statements in this report.

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Blackbaud, Inc.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have market rate sensitivity for interest rates and foreign currency exchange rates.

Interest Rate Risk

Our variable rate debt is our primary financial instrument with market risk exposure for changing interest rates. We manage our variable rate interest rate risk through a combination of short-term and long-term borrowings and the use of derivative instruments entered into for hedging purposes. Due to the nature of our debt, the materiality of the fair values of the derivative instruments and the highly liquid, short-term nature and level of our cash and cash equivalents as of December 31, 2018, we believe there is no material risk of exposure to changing interest rates for those positions. There were no significant changes in how we manage interest rate risk between December 31, 2017 and December 31, 2018.

Foreign Currency Risk

For a discussion of our exposure to foreign currency exchange rate fluctuations, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Foreign Currency Exchange Rates” in Item 7 of this report.

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Blackbaud, Inc.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

BLACKBAUD, INC.
Index to consolidated financial statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Blackbaud, Inc. and its subsidiaries (the "Company") as of December 31, 2018 and 2017, and the related consolidated statements of comprehensive income, cash flows and stockholders’ equity for each of the three years in the period ended December 31, 2018, including the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Change in Accounting Principle

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for revenues from contracts with customers in 2018.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.
/S/ PRICEWATERHOUSECOOPERS LLP
Raleigh, North Carolina
February 20, 2019

We have served as the Company's auditor since 2000.

Blackbaud, Inc.
Consolidated balance sheets

Assets		
Current assets:		
Cash and cash equivalents	$30,866	$29,830
Restricted cash due to customers	418,980	610,344
Accounts receivable, net of allowance of $4,722 and $5,141 at December 31, 2018 and December 31, 2017, respectively	86,595	95,679
Customer funds receivable	1,753	1,536
Prepaid expenses and other current assets	59,788	61,978
Total current assets	597,982	799,367
Property and equipment, net	40,031	42,243
Software development costs, net	75,099	54,098
Goodwill	545,213	530,249
Intangible assets, net	291,617	314,651
Other assets	65,363	57,238
Total assets	$1,615,305	$1,797,846
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	$34,538	$24,693
Accrued expenses and other current liabilities	46,893	54,399
Due to customers	420,733	611,880
Debt, current portion	7,500	8,576
Deferred revenue, current portion	295,991	275,063
Total current liabilities	805,655	974,611
Debt, net of current portion	379,624	429,648
Deferred tax liability	44,291	48,023
Deferred revenue, net of current portion	2,564	3,643
Other liabilities	9,388	5,632
Total liabilities	1,241,522	1,461,557
Commitments and contingencies (see Note 11)		
Stockholders' equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, $0.001 par value; 180,000,000 shares authorized, 59,327,633 and 58,551,761 shares issued at December 31, 2018 and December 31, 2017, respectively	59	59
Additional paid-in capital	399,241	351,042
Treasury stock, at cost; 10,760,574 and 10,475,794 shares at December 31, 2018 and December 31, 2017, respectively	(266,884)	(239,199)
Accumulated other comprehensive loss	(5,110)	(642)
Retained earnings	246,477	225,029
Total stockholders' equity	373,783	336,289
Total liabilities and stockholders' equity	$1,615,305	$1,797,846

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

Blackbaud, Inc.
Consolidated statements of comprehensive income

Revenue			
Recurring	$762,181	$684,583	$609,063
One-time services and other	86,425	103,904	122,579
Total revenue	848,606	788,487	731,642
Cost of revenue			
Cost of recurring	305,481	277,639	246,669
Cost of one-time services and other	76,261	84,265	92,551
Total cost of revenue	381,742	361,904	339,220
Gross profit	466,864	426,583	392,422
Operating expenses			
Sales, marketing and customer success	192,848	169,559	150,157
Research and development	98,811	89,911	89,870
General and administrative	106,354	94,870	81,331
Amortization	4,844	3,271	2,840
Restructuring	4,590	794	—
Total operating expenses	407,447	358,405	324,198
Income from operations	59,417	68,178	68,224
Interest expense	(15,898)	(12,097)	(10,583)
Other income (expense), net	1,103	2,260	(291)
Income before provision for income taxes	44,622	58,341	57,350
Income tax (benefit) provision	(219)	(15,292)	11,946
Net income	$44,841	$73,633	$45,404
Earnings per share			
Basic	$0.95	$1.58	$0.98
Diluted	$0.93	$1.54	$0.96
Common shares and equivalents outstanding			
Basic weighted average shares	47,206,669	46,669,440	46,132,389
Diluted weighted average shares	48,045,084	47,775,702	47,316,538
Other comprehensive (loss) income			
Foreign currency translation adjustment	(5,218)	(789)	205
Unrealized gain on derivative instruments, net of tax	583	751	44
Total other comprehensive (loss) income	(4,635)	(38)	249
Comprehensive income	$40,206	$73,595	$45,653

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

Blackbaud, Inc.
Consolidated statements of cash flows

Cash flows from operating activities			
Net income	$44,841	$73,633	$45,404
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	79,566	73,948	70,491
Provision for doubtful accounts and sales returns	6,890	11,686	3,730
Stock-based compensation expense	48,274	40,631	32,638
Deferred taxes	(619)	(17,814)	5,415
Amortization of deferred financing costs and discount	752	838	958
Other non-cash adjustments	(1,912)	504	(864)
Changes in operating assets and liabilities, net of acquisition and disposal of businesses:			
Accounts receivable	2,166	(15,821)	(13,007)
Prepaid expenses and other assets	(5,217)	(9,550)	(8,495)
Trade accounts payable	9,487	1,024	3,689
Accrued expenses and other liabilities	(2,027)	(4,973)	(751)
Deferred revenue	19,184	22,184	14,420
Net cash provided by operating activities	201,385	176,290	153,628
Cash flows from investing activities			
Purchase of property and equipment	(14,719)	(10,208)	(17,694)
Capitalized software development costs	(37,629)	(28,345)	(26,359)
Purchase of net assets of acquired companies, net of cash and restricted cash acquired	(44,943)	(146,789)	(3,377)
Purchase of derivative instruments	—	(568)	—
Proceeds from settlement of derivative instruments	—	1,030	—
Other investing activities	(500)	—	—
Net cash used in investing activities	(97,791)	(184,880)	(47,430)
Cash flows from financing activities			
Proceeds from issuance of debt	270,900	774,500	227,200
Payments on debt	(322,476)	(679,119)	(293,575)
Debt issuance costs	—	(3,085)	—
Employee taxes paid for withheld shares upon equity award settlement	(27,685)	(23,962)	(15,376)
Proceeds from exercise of stock options	11	15	16
Change in due to customers	(188,502)	226,717	96,000
Change in customer funds receivable	(844)	6,644	—
Dividend payments to stockholders	(23,312)	(23,069)	(22,811)
Net cash (used in) provided by financing activities	(291,908)	278,641	(8,546)
Effect of exchange rate on cash, cash equivalents, and restricted cash	(2,014)	(550)	2,622
Net (decrease) increase in cash, cash equivalents, and restricted cash	(190,328)	269,501	100,274
Cash, cash equivalents, and restricted cash, beginning of year	640,174	370,673	270,399
Cash, cash equivalents, and restricted cash, end of year	$449,846	$640,174	$370,673
Supplemental disclosure of cash flow information			
Cash (paid) received during the year for:			
Interest	(15,261)	(10,614)	(9,608)
Taxes, net of refunds	7,138	(5,613)	(1,340)
Non-cash investing and financing activities:			
Purchase of equipment and other assets included in accounts payable	(882)	(1,546)	(3,155)

Acquired restricted cash liabilities due to customers	—	31,644	—

The following table provides a reconciliation of cash and cash equivalents and restricted cash reported within the consolidated balance sheets that sum to the total of the same such amounts shown above in the consolidated statements of cash flows:

Cash and cash equivalents	$ 30,866	$ 29,830
Restricted cash due to customers	418,980	610,344
Total cash, cash equivalents and restricted cash in the statement of cash flows	$ 449,846	$ 640,174

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

Blackbaud, Inc.
Consolidated statements of stockholders' equity

Balance at December 31, 2015	56,873,817	$ 57	$ 276,340	$ (199,861)	$ (825)	$ 134,877	$ 210,588
Cumulative effect of adoption of ASU 2014-09[1]	—	—	—	—	(28)	17,791	17,763
Cumulative effect upon early adoption of ASU 2016-09[1]	—	—	1,540	—	—	(934)	606
Net income	—	—	—	—	—	45,404	45,404
Payment of dividends ($0.48 per share)	—	—	—	—	—	(22,811)	(22,811)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	341,418	—	16	—	—	—	16
Employee taxes paid for 263,730 withheld shares upon equity award settlement	—	—	—	(15,376)	—	—	(15,376)
Stock-based compensation	—	—	32,556	—	—	82	32,638
Restricted stock grants	574,309	1	—	—	—	—	1
Restricted stock cancellations	(117,143)	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	249	—	249
Balance at December 31, 2016	57,672,401	$ 58	$ 310,452	$ (215,237)	$ (604)	$ 174,409	$ 269,078
Net income	—	—	—	—	—	73,633	73,633
Payment of dividends ($0.48 per share)	—	—	—	—	—	(23,069)	(23,069)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	390,291	—	15	—	—	—	15
Employee taxes paid for 308,993 withheld shares upon equity award settlement	—	—	—	(23,962)	—	—	(23,962)
Stock-based compensation	—	—	40,575	—	—	56	40,631
Restricted stock grants	570,208	1	—	—	—	—	1
Restricted stock cancellations	(81,139)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(38)	—	(38)
Balance at December 31, 2017	58,551,761	$ 59	$ 351,042	$ (239,199)	$ (642)	$ 225,029	$ 336,289
Net income	—	—	—	—	—	44,841	44,841
Payment of dividends ($0.48 per share)	—	—	—	—	—	(23,312)	(23,312)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	349,248	—	11	—	—	—	11
Employee taxes paid for 284,780 withheld shares upon equity award settlement	—	—	—	(27,685)	—	—	(27,685)
Stock-based compensation	—	—	48,188	—	—	86	48,274
Restricted stock grants	541,786	—	—	—	—	—	—
Restricted stock cancellations	(115,162)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(4,635)	—	(4,635)
Reclassification upon early adoption of ASU 2018-02[1]	—	—	—	—	167	(167)	—
Balance at December 31, 2018	59,327,633	$ 59	$ 399,241	$ (266,884)	$ (5,110)	$ 246,477	$ 373,783

(1) Refer to the discussion of recently adopted accounting pronouncements in Note 2 to these consolidated financial statements for additional details.

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

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Blackbaud, Inc.
Notes to consolidated financial statements

1. Organization

We are the world’s leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, companies, education institutions, healthcare organizations and individual change agents—we connect and empower organizations to increase their impact through cloud software, services, expertise and data intelligence. Our portfolio is tailored to the unique needs of vertical markets, with solutions for fundraising and CRM, marketing, advocacy, peer-to-peer fundraising, corporate social responsibility, school management, ticketing, grantmaking, financial management, payment processing and analytics. Serving the industry for more than three decades, we are headquartered in Charleston, South Carolina and have operations in the United States, Australia, Canada, Costa Rica and the United Kingdom. As of December 31, 2018, we had over 45,000 customers.

2. Basis of Presentation

Basis of presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”).

Reclassifications

Our revenue from "subscriptions" and "maintenance" and a portion of our "services and other" revenue have been combined within "recurring" revenue beginning in 2018. In order to provide comparability between periods presented, those amounts of revenue have been combined within "recurring" revenue in the previously reported consolidated statements of comprehensive income to conform to the presentation of the current period. Similarly, "cost of subscriptions" and "cost of maintenance" and a portion of "cost of services and other" have been combined within "cost of recurring" in the previously reported consolidated statements of comprehensive income to conform to the presentation of the current period. "Services and other" revenue has been renamed as "one-time services and other" revenue and consists of revenue that did not meet the description of "recurring" revenue in the consolidated statements of comprehensive income. "Cost of services and other" has been renamed as "cost of one-time services and other" and consists of costs that did not meet the description of those related to "recurring" revenue in the consolidated statements of comprehensive income.

Basis of consolidation

The consolidated financial statements include the accounts of Blackbaud, Inc. and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, we reconsider and evaluate our estimates and assumptions, including those that impact revenue recognition, long-lived and intangible assets including goodwill, income taxes, business combinations, stock-based compensation, capitalization of software development costs, our allowances for sales returns and doubtful accounts, costs of obtaining contracts, valuation of derivative instruments and loss contingencies, among others. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could materially differ from these estimates.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)

Recently adopted accounting pronouncements

As previously disclosed, during the three months ended September 30, 2016 we early adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-09, *Compensation - Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09")*, which addresses, among other items, the accounting for income taxes and forfeitures, and cash flow presentation of share-based compensation. Our adoption of ASU 2016-09 required us to reflect any adjustments as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. Upon adoption, we elected to account for forfeitures as they occur using a modified retrospective transition method, which resulted in a cumulative-effect adjustment of $0.9 million to reduce our January 1, 2016 opening retained earnings balance. Adoption of the new standard also resulted in the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital of $7.7 million for the year ended December 31, 2016.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 replaces most previous revenue recognition guidance in GAAP and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also provides guidance on the recognition of costs related to obtaining and fulfilling customer contracts.

We adopted ASU 2014-09 as of January 1, 2018 utilizing the full retrospective method of transition, which requires that the standard be applied to all periods presented. The impact of adopting ASU 2014-09 on our total revenues for 2017 and 2016 was not material. The primary impacts of adopting ASU 2014-09 relate to the deferral of incremental commission and other costs of obtaining contracts with customers and the increase to the amortization period for those costs. Previously, we deferred only direct and incremental commission costs to obtain a contract and amortized those costs over the contract term, generally three years, as the revenue was recognized. Under the new standard, we defer all incremental commission and related fringe benefit costs to obtain a contract and amortize these costs in a manner that aligns with the expected period of benefit. We utilized the 'portfolio approach' practical expedient in ASC 606-10-10-4, which allows entities to apply the guidance to a portfolio of contracts with similar characteristics because the effects on the financial statements of this approach would not differ materially from applying the guidance to individual contracts. Using the 'portfolio approach' and taking into consideration our customer contracts, our technology and other factors, we determined the expected period of benefit to be five years. We do not generally pay commissions for contract renewals.

Select adjusted financial statement information, which reflects our adoption of ASU 2014-09 is set forth below.

Consolidated balance sheets:

Accounts receivable, net of allowance	$ 88,932	$ (671)	$ 88,261	$ 96,293	$ (614)	$ 95,679
Prepaid expenses and other current assets	$ 48,314	$ 5,897	$ 54,211	$ 56,099	$ 5,879	$ 61,978

Other assets	$22,524	$29,573	$52,097	$24,083	$33,155	$57,238
Deferred revenue, current portion	$244,500	$(651)	$243,849	$276,456	$(1,393)	$275,063
Deferred tax liability	$29,558	$13,917	$43,475	$37,597	$10,426	$48,023
Retained earnings	$152,729	$21,680	$174,409	$195,649	$29,380	$225,029

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)

Consolidated statements of comprehensive income:

Revenue						
Recurring	$ 575,933	$ 33,130	$ 609,063	$ 651,031	$ 33,552	$ 684,583
One-time services and other	154,882	(32,303)	122,579	137,275	(33,371)	103,904
Total revenue	$ 730,815	$ 827	$ 731,642	$ 788,306	$ 181	$ 788,487
Cost of revenue						
Recurring	$ 235,977	$ 10,692	$ 246,669	$ 265,713	$ 11,926	$ 277,639
One-time services and other	103,243	(10,692)	92,551	96,191	(11,926)	84,265
Total cost of revenue	$ 339,220	$ —	$ 339,220	$ 361,904	$ —	$ 361,904
Operating expenses						
Sales, marketing and customer success	$ 155,754	$ (5,597)	$ 150,157	$ 173,525	$ (3,966)	$ 169,559
Net income	$ 41,515	$ 3,889	$ 45,404	$ 65,933	$ 7,700	$ 73,633
Basic earnings per share	$ 0.90	$ 0.08	$ 0.98	$ 1.41	$ 0.17	$ 1.58
Diluted earnings per share	$ 0.88	$ 0.08	$ 0.96	$ 1.38	$ 0.16	$ 1.54

(1) See the discussion of our reclassifications of previously reported revenue and costs of revenue above.

Our adoption of ASU 2014-09 had no impact on our net cash provided by or used in operating, investing or financing activities for any of the periods reported.

In February 2018, the FASB issued ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* (“ASU 2018-02”), which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the U.S. Tax Cuts and Jobs Act (the “Tax Act”) signed into law in December 2017. We early adopted ASU 2018-02 effective January 1, 2018 and recorded an insignificant reclassification for the stranded tax effects resulting from the Tax Act from accumulated other comprehensive loss to retained earnings.

Recently issued accounting pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 will require lessees to record most leases on their balance sheets but recognize expenses in the income statement in a manner similar to current guidance. The updated guidance also eliminates certain real estate-specific provisions and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs for all entities. All entities will classify leases to determine how to recognize lease-related revenue and expense. Upon adoption, entities will be required to use a modified retrospective approach with an option to use certain practical expedients. We expect to adopt ASU 2016-02 when effective, using the transition method that allows us to initially apply the guidance at the adoption date of January 1, 2019 and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We expect to use the package of practical expedients that allows us to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases and (3) initial direct costs for any expired or existing leases. We expect ASU 2016-02 will impact our consolidated financial statements and related disclosures. We are currently evaluating the extent of the impact and expect that most of our lease commitments will be subject to the updated guidance and recognized as lease liabilities and right-of-use assets on our consolidated balance sheets upon adoption. Based on our portfolio of leases as of December 31, 2018, and our evaluation to date, we expect to recognize aggregate lease liabilities of between $105 million and $135 million, primarily relating to real estate.

Summary of significant accounting policies

Revenue recognition

Our revenue is primarily generated from the following sources: (i) charging for the use of our software solutions in cloud-based and hosted environments; (ii) providing payment and transaction services; (iii) providing software maintenance and

Blackbaud, Inc.
Notes to consolidated financial statements (continued)

support services; and (iv) providing professional services, including implementation, consulting, training, analytic and other services. Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

We determine revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when, or as, we satisfy a performance obligation.

Recurring

Recurring revenue represents stand-ready performance obligations in which we are making our solutions or services available to our customers continuously over time or the value of the contract renews. Therefore, recurring revenue is generally recognized over time on a ratable basis over the contract term, beginning on the date that the solution or service is made available to the customer. Our recurring revenue contracts are generally for a term of three years at contract inception with one to three-year renewals thereafter, billed annually in advance and non-cancelable.

Recurring revenue is comprised of fees for the use of our subscription-based software solutions, which includes providing access to cloud-based solutions, hosting services, online training programs, subscription-based analytic services, such as donor acquisitions and data enrichment, and payment services. Recurring revenue also includes fees from maintenance services for our on-premises solutions, services included in our renewable subscription contracts, subscription-based contracts for professional services and variable transaction revenue associated with the use of our solutions.

Our payment services are offered with the assistance of third-party vendors. In general, when we are the principal in a transaction based on the factors identified in ASC 606-10-55-36 through 55-40, we record the revenue and related costs on a gross basis. Otherwise, we net the cost of revenue associated with the service against the gross revenue (amount billed to the customer) and record the net amount as revenue. For payment and transaction services, we have the right to invoice the customer in an amount that directly corresponds with the value to the customer of our performance to date. Therefore, we recognize revenue for these services over time based on the amount billable to the customer in accordance with the 'as invoiced' practical expedient in ASC 606-10-55-18.

One-time services and other

One-time services and other revenue primarily consists of fees for one-time consulting, analytic and onsite training services.

We generally bill consulting services based on hourly rates plus reimbursable travel-related expenses. Fixed price consulting engagements are generally billed as milestones towards completion are reached. Revenue for all consulting services is recognized over time as the services are performed.

We generally recognize analytic services revenue from donor prospect research engagements, the sale of lists of potential donors, data enrichment engagements and benchmarking studies at a point in time (upon delivery).

In certain cases, we sell training at a fixed rate for each specific class at a per attendee price or at a packaged price for several attendees, and recognize the related revenue upon the customer attending and completing training.

Contracts with multiple performance obligations

Some of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of our solutions and services are typically estimated based on observable transactions when the solutions or services are sold on a standalone basis.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)

Costs of obtaining contracts, contract assets and deferred revenue

We pay sales commissions at the time contracts with customers are signed or shortly thereafter, depending on the size and duration of the sales contract. Sales commissions and related fringe benefits earned by our sales force are considered incremental and recoverable costs of obtaining a contract with a customer. These costs are deferred and then amortized in a manner that aligns with the expected period of benefit, which we have determined to be five years. We determined the period of benefit by taking into consideration our customer contracts, including renewals, retention, our technology and other factors. We do not generally pay commissions for contract renewals. The related amortization expense is included in sales, marketing and customer success expense in our consolidated statements of comprehensive income.

A contract asset is recorded when revenue is recognized in advance of our right to receive consideration (i.e., we must satisfy additional performance obligations in order to receive consideration). Amounts are recorded as receivables when our right to consideration is unconditional (i.e., only the passage of time is required before payment of the consideration is due). Our contract assets are recorded within prepaid expenses and other current assets on our consolidated balance sheets. To the extent that our customers are billed for our solutions and services in advance of us satisfying the related performance obligations, we record such amounts in deferred revenue.

Fair value measurements

We measure certain financial assets and liabilities at fair value on a recurring basis, including derivative instruments. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. An active market is defined as a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. We use a three-tier fair value hierarchy to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets;
- Level 2 - Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3 - Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

Our financial assets and liabilities are classified in their entirety within the hierarchy based on the lowest level of input that is significant to fair value measurement. Changes to a financial asset's or liability's level within the fair value hierarchy are determined as of the end of a reporting period. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

Derivative instruments

We generally use derivative instruments to manage interest rate risk. We view derivative instruments as risk management tools and do not use them for trading or speculative purposes. Our policy requires that derivatives used for hedging purposes be designated and effective as a hedge of the identified risk exposure at the inception of the contract. Accordingly, changes in fair value of the derivative contract must be highly correlated with changes in the fair value of the underlying hedged item at inception of the hedge and over the life of the hedge contract.

We record all derivative instruments on our consolidated balance sheets at fair value. If the derivative is designated as a cash flow hedge, the effective portions of the changes in fair value of the derivative are recorded in other comprehensive income and reclassified to earnings in a manner that matches the timing of the earnings impact of the hedged transactions. Ineffective portions of the changes in the fair value of cash flow hedges are recognized currently in earnings. See Note 10 of these consolidated financial statements for further discussion of our derivative instruments.

Sales taxes

We present sales taxes and other taxes collected from customers and remitted to governmental authorities on a net basis and, as such, exclude them from revenues.

Blackbaud, Inc.
Notes to consolidated financial statements (continued)

Cash and cash equivalents
We consider all highly liquid investments purchased with an original maturity of three months or less and cash items in transit to be cash equivalents.
Restricted cash due to customers; Customer funds receivable; Due to customers
Restricted cash due to customers consists of monies collected by us and payable to our customers, net of the associated transaction fees earned. Monies associated with amounts due to customers are segregated in separate bank accounts and used exclusively for the payment of amounts due to customers. This usage restriction is either legally or internally imposed and reflects our intention with regard to such deposits. Customer funds receivable consists of monies we expect to collect and remit to our customers.
Concentration of credit risk
Financial instruments that potentially subject us to concentrations of credit risk consist of cash and cash equivalents, restricted cash due to customers and accounts receivable. Our cash and cash equivalents and restricted cash due to customers are placed with high credit-quality financial institutions. Our accounts receivable is derived from sales to customers who primarily operate in the nonprofit sector. With respect to accounts receivable, we perform ongoing evaluations of our customers and maintain an allowance for doubtful accounts based on historical experience and our expectations of future losses. As of and for the years ended December 31, 2018, 2017 and 2016, there were no significant concentrations with respect to our consolidated revenues or accounts receivable.
Property and equipment
We record property and equipment assets at cost and depreciate them over their estimated useful lives using the straight-line method. Leasehold improvements are depreciated over the lesser of the term of the lease or the estimated useful life of the asset. Upon retirement or sale, the cost of assets disposed of and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is credited or charged to earnings. Repair and maintenance costs are expensed as incurred.
Construction-in-progress represents purchases of computer software and hardware associated with new internal system implementation projects which had not been placed in service at the respective balance sheet dates. We transferred these assets to the applicable property category on the date they are placed in service. There was no capitalized interest applicable to construction-in-progress for the years ended December 31, 2018, 2017 and 2016.
Business combinations
We include the operating results of acquired companies as well as the net assets acquired and liabilities assumed in our consolidated financial statements from the date of acquisition. We are required to allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed at the acquisition date based upon their estimated fair values. Goodwill as of the acquisition date represents the excess of the purchase consideration of an acquired business over the fair value of the underlying net tangible and intangible assets acquired and liabilities assumed. This allocation and valuation require management to make significant estimates and assumptions, especially with respect to long-lived and intangible assets.
Critical estimates in valuing intangible assets include, but are not limited to, estimates about: future expected cash flows from customer contracts, proprietary technology and non-compete agreements; the acquired company's brand awareness and market position, assumptions

about the period of time the brand will continue to be valuable; as well as expected costs to develop any in-process research and development into commercially viable solutions and estimated cash flows from the projects when completed, and discount rates. Our estimates of fair value are based upon assumptions we believe to be reasonable, but which are inherently uncertain and unpredictable, and unanticipated events and changes in circumstances may occur.

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Goodwill

Goodwill represents the purchase price in excess of the net amount assigned to assets acquired and liabilities assumed by us in a business combination. Goodwill is not amortized, but tested annually for impairment on the first day of our fourth quarter, or more frequently if indicators of potential impairment arise.

Accounting guidance permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis to determine whether it is necessary to perform the quantitative impairment test. Significant judgment is required in the assessment of qualitative factors, including but not limited to an evaluation of macroeconomic conditions as they relate to our business, industry and market trends, as well as the ov