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

FORM 10-Q

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

For the quarterly period ended June 30, 2019

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	Trading Symbol(s)	Name of Each Exchange on which Registered
Common Stock, $0.001 Par Value	**BLKB**	**Nasdaq Global Select Market**

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

Indicate by check mark whether the registrant has submitted electronically 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 ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☑	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 ☑

The number of shares of the registrant’s Common Stock outstanding as of July 24, 2019 was 49,173,478.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, 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, 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,” “likely,” “will,” “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, in our Annual Report on Form 10-K for the year ended December 31, 2018 and in our other SEC filings. Forward-looking statements represent our management's beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q. 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 statement, whether as a result of new information, future events or otherwise.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Blackbaud, Inc.
Consolidated balance sheets
(Unaudited)

(dollars in thousands)	June 30, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 32,654	$ 30,866
Restricted cash due to customers	354,133	418,980
Accounts receivable, net of allowance of $5,231 and $4,722 at June 30, 2019 and December 31, 2018, respectively	131,277	86,595
Customer funds receivable	5,349	1,753
Prepaid expenses and other current assets	76,728	59,788
Total current assets	600,141	597,982
Property and equipment, net	39,569	40,031
Operating lease right-of-use assets	107,165	—
Software development costs, net	87,880	75,099
Goodwill	632,269	545,213
Intangible assets, net	340,615	291,617
Other assets	66,319	65,363
Total assets	$ 1,873,958	$ 1,615,305
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	$ 35,749	$ 34,538
Accrued expenses and other current liabilities	60,514	46,893
Due to customers	359,482	420,733
Debt, current portion	7,500	7,500
Deferred revenue, current portion	327,299	295,991
Total current liabilities	790,544	805,655
Debt, net of current portion	553,812	379,624
Deferred tax liability	48,658	44,291
Deferred revenue, net of current portion	2,324	2,564
Operating lease liabilities, net of current portion	100,116	—
Other liabilities	5,802	9,388
Total liabilities	1,501,256	1,241,522
Commitments and contingencies (see Note 10)		
Stockholders' equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, $0.001 par value; 180,000,000 shares authorized, 60,187,063 and 59,327,633 shares issued at June 30, 2019 and December 31, 2018, respectively	60	59
Additional paid-in capital	427,950	399,241
Treasury stock, at cost; 11,017,004 and 10,760,574 shares at June 30, 2019 and December 31, 2018, respectively	(286,644)	(266,884)
Accumulated other comprehensive loss	(9,409)	(5,110)
Retained earnings	240,745	246,477
Total stockholders' equity	372,702	373,783
Total liabilities and stockholders' equity	$ 1,873,958	$ 1,615,305

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

Blackbaud, Inc.
Consolidated statements of comprehensive income
(Unaudited)

(dollars in thousands, except per share amounts)	Three months ended June 30, 2019	Three months ended June 30, 2018	Six months ended June 30, 2019	Six months ended June 30, 2018
Revenue				
Recurring	$ 208,468	$ 192,749	$ 406,562	$ 373,595
One-time services and other	17,166	20,923	34,902	44,261
Total revenue	225,634	213,672	441,464	417,856
Cost of revenue				
Cost of recurring	86,657	76,350	171,368	145,429
Cost of one-time services and other	14,150	18,822	28,722	37,780
Total cost of revenue	100,807	95,172	200,090	183,209
Gross profit	124,827	118,500	241,374	234,647
Operating expenses				
Sales, marketing and customer success	55,009	48,493	110,464	93,970
Research and development	25,902	25,297	54,363	51,255
General and administrative	28,543	28,447	55,660	53,498
Amortization	1,152	1,201	2,528	2,470
Restructuring	730	3,688	2,683	4,499
Total operating expenses	111,336	107,126	225,698	205,692
Income from operations	13,491	11,374	15,676	28,955
Interest expense	(5,799)	(4,303)	(11,122)	(7,820)
Other income, net	2,181	346	2,363	506
Income before provision for income taxes	9,873	7,417	6,917	21,641
Income tax provision (benefit)	2,733	825	899	(2,702)
Net income	$ 7,140	$ 6,592	$ 6,018	$ 24,343
Earnings per share				
Basic	$ 0.15	$ 0.14	$ 0.13	$ 0.52
Diluted	$ 0.15	$ 0.14	$ 0.13	$ 0.51
Common shares and equivalents outstanding				
Basic weighted average shares	47,714,621	47,222,657	47,622,740	47,121,692
Diluted weighted average shares	48,160,684	48,053,094	48,101,212	48,030,547
Other comprehensive (loss) income				
Foreign currency translation adjustment	(6,018)	(8,817)	(1,428)	(2,380)
Unrealized (loss) gain on derivative instruments, net of tax	(1,939)	765	(2,871)	1,844
Total other comprehensive loss	(7,957)	(8,052)	(4,299)	(536)
Comprehensive (loss) income	$ (817)	$ (1,460)	$ 1,719	$ 23,807

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

Blackbaud, Inc.
Consolidated statements of cash flows
(Unaudited)

(dollars in thousands)	Six months ended June 30, 2019	Six months ended June 30, 2018
Cash flows from operating activities		
Net income	$ 6,018	$ 24,343
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	43,113	39,847
Provision for doubtful accounts and sales returns	4,646	3,697
Stock-based compensation expense	28,755	24,953
Deferred taxes	465	1,121
Amortization of deferred financing costs and discount	376	376
Other non-cash adjustments	1,982	(419)
Changes in operating assets and liabilities, net of acquisition and disposal of businesses:		
Accounts receivable	(45,071)	(38,092)
Prepaid expenses and other assets	(12,725)	(18,629)
Trade accounts payable	216	6,327
Accrued expenses and other liabilities	(9,014)	(6,675)
Deferred revenue	26,328	29,545
Net cash provided by operating activities	45,089	66,394
Cash flows from investing activities		
Purchase of property and equipment	(6,375)	(9,575)
Capitalized software development costs	(23,206)	(16,359)
Purchase of net assets of acquired companies, net of cash and restricted cash acquired	(109,386)	(45,315)
Other investing activities	500	—
Net cash used in investing activities	(138,467)	(71,249)
Cash flows from financing activities		
Proceeds from issuance of debt	329,100	173,500
Payments on debt	(155,150)	(132,150)
Employee taxes paid for withheld shares upon equity award settlement	(19,760)	(25,184)
Proceeds from exercise of stock options	6	11
Change in due to customers	(107,808)	(309,189)
Change in customer funds receivable	(3,741)	(4,391)
Dividend payments to stockholders	(11,802)	(11,653)
Net cash provided by (used in) financing activities	30,845	(309,056)
Effect of exchange rate on cash, cash equivalents and restricted cash	(526)	(1,606)
Net decrease in cash, cash equivalents and restricted cash	(63,059)	(315,517)
Cash, cash equivalents and restricted cash, beginning of period	449,846	640,174
Cash, cash equivalents and restricted cash, end of period	$ 386,787	$ 324,657

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:

(dollars in thousands)	June 30, 2019	December 31, 2018
Cash and cash equivalents	$ 32,654	$ 30,866
Restricted cash due to customers	354,133	418,980
Total cash, cash equivalents and restricted cash in the statement of cash flows	$ 386,787	$ 449,846

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

Blackbaud, Inc.
Consolidated statements of stockholders' equity
(Unaudited)

(dollars in thousands)	Common stock Shares	Common stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income (loss)	Retained earnings	Total stockholders' equity
Balance at December 31, 2018	59,327,633	$ 59	$ 399,241	$ (266,884)	$ (5,110)	$ 246,477	$ 373,783
Net loss	—	—	—	—	—	(1,122)	(1,122)
Payment of dividends ($0.12 per share)	—	—	—	—	—	(5,901)	(5,901)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	234,453	—	3	—	—	—	3
Employee taxes paid for 239,311 withheld shares upon equity award settlement	—	—	—	(18,400)	—	—	(18,400)
Stock-based compensation	—	—	13,693	—	—	33	13,726
Restricted stock grants	663,906	1	—	—	—	—	1
Restricted stock cancellations	(43,314)	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	3,658	—	3,658
Balance at March 31, 2019	60,182,678	$ 60	$ 412,937	$ (285,284)	$ (1,452)	$ 239,487	$ 365,748
Net income	—	—	—	—	—	7,140	7,140
Payment of dividends ($0.12 per share)	—	—	—	—	—	(5,901)	(5,901)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	21,726	—	3	—	—	—	3
Employee taxes paid for 17,119 withheld shares upon equity award settlement	—	—	—	(1,360)	—	—	(1,360)
Stock-based compensation	—	—	15,010	—	—	19	15,029
Restricted stock grants	12,405	—	—	—	—	—	—
Restricted stock cancellations	(29,746)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(7,957)	—	(7,957)
Balance at June 30, 2019	60,187,063	$ 60	$ 427,950	$ (286,644)	$ (9,409)	$ 240,745	$ 372,702

Blackbaud, Inc.
Consolidated statements of stockholders' equity (continued)
(Unaudited)

(dollars in thousands)	Common stock Shares	Common stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive income (loss)	Retained earnings	Total stockholders' equity
Balance at December 31, 2017	58,551,761	$ 59	$ 351,042	$ (239,199)	$ (642)	$ 225,029	$ 336,289
Net income	—	—	—	—	—	17,751	17,751
Payment of dividends ($0.12 per share)	—	—	—	—	—	(5,825)	(5,825)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	279,422	—	9	—	—	—	9
Employee taxes paid for 234,454 withheld shares upon equity award settlement	—	—	—	(22,511)	—	—	(22,511)
Stock-based compensation	—	—	11,062	—	—	30	11,092
Restricted stock grants	437,878	—	—	—	—	—	—
Restricted stock cancellations	(35,218)	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	7,516	—	7,516
Reclassification upon early adoption of ASU 2018-02					167	(167)	—
Balance at March 31, 2018	59,233,843	$ 59	$ 362,113	$ (261,710)	$ 7,041	$ 236,818	$ 344,321
Net income	—	—	—	—	—	6,592	6,592
Payment of dividends ($0.12 per share)	—	—	—	—	—	(5,828)	(5,828)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	40,741	—	2	—	—	—	2
Employee taxes paid for 25,678 withheld shares upon equity award settlement	—	—	—	(2,673)	—	—	(2,673)
Stock-based compensation	—	—	13,834	—	—	27	13,861
Restricted stock grants	68,313	—	—	—	—	—	—
Restricted stock cancellations	(41,688)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(8,052)	—	(8,052)
Balance at June 30, 2018	59,301,209	$ 59	$ 375,949	$ (264,383)	$ (1,011)	$ 237,609	$ 348,223

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

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

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.

2. Basis of Presentation

Unaudited interim consolidated financial statements

The accompanying interim consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statements of cash flows and consolidated statements of stockholders’ equity, for the periods presented in accordance with accounting principles generally accepted in the United States ("U.S.") ("GAAP"). The consolidated balance sheet at December 31, 2018, has been derived from the audited consolidated financial statements at that date. Operating results and cash flows for the six months ended June 30, 2019 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2019, or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2018, and other forms filed with the SEC from time to time.

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.

Reportable segment

We report our operating results and financial information in one operating and reportable segment. Our chief operating decision maker uses consolidated financial information to make operating decisions, assess financial performance and allocate resources. Our chief operating decision maker is our chief executive officer ("CEO").

Recently adopted accounting pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 requires lessees to record most leases on their balance sheet but recognize expenses in the income statement in a manner similar to previous guidance. The way in which entities classify leases determines how to recognize lease-related revenue and expense.

We adopted ASU 2016-02 as of January 1, 2019 using the transition method that allowed us to initially apply the guidance at the adoption date of January 1, 2019 without adjusting comparative periods presented. We elected to use the package of practical expedients that allowed 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 existing leases. We did not elect to use the hindsight practical expedient, which permits entities to use hindsight in determining the lease term and assessing impairment. Additionally, we elected not to apply the recognition requirements of the new lease accounting standard to short-term leases. Adopting ASU 2016-02 had a material impact on our consolidated balance sheet as of January 1, 2019, as we recognized $121.6 million of lease liabilities and $113.4 million of right-of-use ("ROU") assets for those leases classified as operating leases.

Summary of significant accounting policies

Except for the accounting policy added for leases below as a result of adopting ASU 2016-02, there have been no changes to our significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC on February 20, 2019, that have had a material impact on our consolidated financial statements.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease ROU assets, accrued expense and other current liabilities, and operating lease liabilities, net of current portion in our consolidated balance sheet as of June 30, 2019.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. We use the implicit rate when readily determinable. The operating lease ROU asset also includes any initial direct costs and lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments related to our operating leases is recognized on a straight-line basis over the lease term. We have lease agreements with lease and non-lease components, which are generally accounted for separately. We do not recognize short-term leases (those that, at the commencement date, have a lease term of 12 months or less) on our consolidated balance sheets. Variable lease payments, which are primarily comprised of common-area maintenance, utilities and real estate taxes that are passed on from the lessor in proportion to the space leased by us, are recognized in operating expenses in the period in which the obligation for those payments is incurred.

3. Business Combinations

YourCause acquisition

On January 2, 2019, we acquired all of the outstanding equity securities, including all voting equity interests, of YourCause Holdings, LLC, a Delaware limited liability company ("YourCause"), pursuant to a purchase 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. We acquired the equity securities for an aggregate purchase price of $157.7 million in cash, subject to certain adjustments set forth in the agreement and plan of merger. The purchase price and related expenses were funded primarily through borrowings under the 2017 Credit Facility (as defined below). As a result of the acquisition, YourCause has become a wholly owned subsidiary of ours. The operating results of YourCause have been included in our consolidated financial statements from the date of acquisition. During the three and six months ended June 30, 2019, we incurred insignificant acquisition-related expenses associated with the acquisition, which were recorded in general and administrative expense.

The fair values assigned to the assets acquired and liabilities assumed in the table below are based on our best estimates and assumptions as of the reporting date and are considered preliminary pending finalization. The estimates and assumptions are subject to change as we obtain additional information during the measurement period, which may be up to one year from the acquisition date. The assets and liabilities, pending finalization, include the valuation of intangible assets as well as the assumed deferred revenue and deferred income tax balances.

(in thousands)		Purchase price allocation
Net working capital, excluding deferred revenue	$	3,576
Other long-term assets		2,574
Identifiable intangible assets		74,690
Deferred tax liability		(4,615)
Deferred revenue		(4,300)
Other long-term liabilities		(1,650)
Goodwill		87,473
Total purchase price	$	157,748

The estimated fair value of accounts receivable acquired approximates the contractual value of $4.1 million and $54.7 million of the goodwill arising in the acquisition is deductible for income tax purposes. The estimated goodwill recognized is attributable primarily to the opportunities for expected synergies from combining the operations and assembled workforce of YourCause. During the six months ended June 30, 2019, we recorded an insignificant measurement period adjustment to the estimated fair value of the YourCause assets acquired and liabilities assumed following the receipt of new information. The adjustment resulted in an increase to net working capital, excluding deferred revenue, with the corresponding offset to goodwill.

The YourCause acquisition resulted in the identification of the following identifiable intangible assets:

YourCause		Intangible assets acquired (in thousands)	Weighted average amortization period (in years)
Acquired technology	$	47,800	12
Customer relationships		25,900	15
Marketing assets		830	2
Non-compete agreements		160	0
Total intangible assets	$	74,690	13

The estimated fair values of the intangible assets were based on variations of the income approach, which estimates fair value based upon the present value of cash flows that the assets are expected to generate, and which included the relief-from-royalty method, incremental cash flow method, including the comparative (with and without) method and multi-period excess earnings method, depending on the intangible asset being valued. The method of amortization of identifiable finite-lived intangible assets is based on the expected pattern in which the estimated economic benefits of the respective assets are consumed or otherwise used up. Customer relationships and acquired technology assets are being amortized on an accelerated basis. Marketing assets are being amortized on a straight-line basis. The non-compete agreements were fully amortized as of March 31, 2019, based on the insignificance of the acquired assets.

We determined that the impact of this acquisition was not material to our consolidated financial statements; therefore, separate presentation of revenue and earnings since the acquisition date and pro forma information are not required nor included herein.

4. Goodwill and Other Intangible Assets

The change in goodwill during the six months ended June 30, 2019, consisted of the following:

(dollars in thousands)		Total
Balance at December 31, 2018	$	545,213
Additions related to current year business combinations		87,473
Effect of foreign currency translation		(417)
Balance at June 30, 2019	$	632,269

5. Earnings Per Share

We compute basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common shares outstanding during the period. Diluted earnings per share reflect the assumed exercise, settlement and vesting of all dilutive securities using the “treasury stock method” except when the effect is anti-dilutive. Potentially dilutive securities consist of shares issuable upon the exercise of stock options, settlement of stock appreciation rights and vesting of restricted stock awards and units.

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended June 30,				Six months ended June 30,			
(dollars in thousands, except per share amounts)		2019		2018		2019		2018
Numerator:								
Net income	$	7,140	$	6,592	$	6,018	$	24,343
Denominator:								
Weighted average common shares		47,714,621		47,222,657		47,622,740		47,121,692
Add effect of dilutive securities:								
Stock-based awards		446,063		830,437		478,472		908,855
Weighted average common shares assuming dilution		48,160,684		48,053,094		48,101,212		48,030,547
Earnings per share:								
Basic	$	0.15	$	0.14	$	0.13	$	0.52
Diluted	$	0.15	$	0.14	$	0.13	$	0.51
Anti-dilutive shares excluded from calculations of diluted earnings per share		245,060		—		748,743		37

6. Fair Value Measurements

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.

Recurring fair value measurements

Assets and liabilities that are measured at fair value on a recurring basis consisted of the following, as of the dates indicated below:

	Fair value measurement using			
(dollars in thousands)	Level 1	Level 2	Level 3	Total
Fair value as of June 30, 2019				
Financial liabilities:				
Derivative instruments	$ —	$ 1,826	$ —	$ 1,826
Total financial liabilities	$ —	$ 1,826	$ —	$ 1,826
Fair value as of December 31, 2018				
Financial assets:				
Derivative instruments	$ —	$ 2,260	$ —	$ 2,260
Total financial assets	$ —	$ 2,260	$ —	$ 2,260
Fair value as of December 31, 2018				
Financial liabilities:				
Derivative instruments	$ —	$ 186	$ —	$ 186
Total financial liabilities	$ —	$ 186	$ —	$ 186

Our derivative instruments within the scope of Accounting Standards Codification ("ASC") 815, *Derivatives and Hedging*, are required to be recorded at fair value. Our derivative instruments that are recorded at fair value include interest rate swaps.

The fair value of our interest rate swaps was based on model-driven valuations using LIBOR rates, which are observable at commonly quoted intervals. Accordingly, our interest rate swaps are classified within Level 2 of the fair value hierarchy.

We believe the carrying amounts of our cash and cash equivalents, restricted cash due to customers, accounts receivable, trade accounts payable, accrued expenses and other current liabilities and due to customers approximate their fair values at June 30, 2019 and December 31, 2018, due to the immediate or short-term maturity of these instruments.

We believe the carrying amount of our debt approximates its fair value at June 30, 2019 and December 31, 2018, as the debt bears interest rates that approximate market value. As LIBOR rates are observable at commonly quoted intervals, our debt is classified within Level 2 of the fair value hierarchy.

We did not transfer any assets or liabilities among the levels within the fair value hierarchy during the six months ended June 30, 2019. Additionally, we did not hold any Level 3 assets or liabilities during the six months ended June 30, 2019.

Non-recurring fair value measurements

Assets and liabilities that are measured at fair value on a non-recurring basis include intangible assets, goodwill and operating lease ROU assets, which are recognized at fair value during the period in which an acquisition is completed or at lease commencement, from updated estimates and assumptions during the measurement period, or when they are considered to be impaired. These non-recurring fair value measurements, primarily for intangible assets acquired and operating lease ROU assets, are based on Level 3 unobservable inputs. In the event of an impairment, we determine the fair value of the intangible assets other than goodwill using a discounted cash flow approach, which contains significant unobservable inputs and, therefore, is considered a Level 3 fair value measurement. The unobservable inputs in the analysis generally include future cash flow projections and a discount rate. For goodwill impairment testing, we estimate fair value using market-based methods including the use of market capitalization and consideration of a control premium.

During the six months ended June 30, 2019, we recorded $1.3 million in impairments of operating lease ROU assets associated with certain leased office spaces we ceased using as part of our facilities optimization restructuring. These impairments were recorded as restructuring expense on our consolidated statements of comprehensive income. See Note 15 to these consolidated financial statements for additional details regarding our facilities optimization restructuring.

There were no non-recurring fair value adjustments to intangible assets and goodwill during the six months ended June 30, 2019, except for an insignificant business combination accounting adjustment to the initial fair value estimates of the YourCause assets acquired and liabilities assumed at the acquisition date from updated information obtained during the measurement period. See Note 3 to these consolidated financial statements for additional details. We record any measurement period adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill.

7. Consolidated Financial Statement Details

Prepaid expenses and other assets

(dollars in thousands)	June 30, 2019	December 31, 2018
Costs of obtaining contracts(1)(2)	$ 90,119	$ 85,590
Prepaid software maintenance and subscriptions	31,705	21,134
Unbilled accounts receivable	5,691	4,161
Taxes, prepaid and receivable	3,586	2,055
Security deposits	945	1,020
Other assets	11,001	11,191
Total prepaid expenses and other assets	143,047	125,151
Less: Long-term portion	66,319	65,363
Prepaid expenses and other current assets	$ 76,728	$ 59,788

(1) Amortization expense from costs of obtaining contracts was $9.8 million and $19.4 million for the three and six months ended June 30, 2019, respectively, and $9.1 million and $17.6 million for the three and six months ended June 30, 2018, respectively.
(2) The current portion of costs of obtaining contracts as of June 30, 2019 and December 31, 2018 was $32.3 million and $31.7 million, respectively.

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

Accrued expenses and other liabilities

(dollars in thousands)	June 30, 2019	December 31, 2018
Operating lease liabilities, current portion (1)	$ 16,155	$ —
Accrued bonuses	14,301	14,868
Accrued commissions and salaries	7,760	9,934
Taxes payable	6,391	6,204
Customer credit balances	4,090	4,076
Unrecognized tax benefit	3,747	2,719
Accrued vacation costs	2,041	2,352
Accrued health care costs	1,806	1,497
Other liabilities	10,025	14,631
Total accrued expenses and other liabilities	66,316	56,281
Less: Long-term portion	5,802	9,388
Accrued expenses and other current liabilities	$ 60,514	$ 46,893

(1) Upon adoption of ASU 2016-02 at January 1, 2019, we recognized lease liabilities for our operating leases. See Note 2 of these consolidated financial statements for details.

Other income, net

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2019	2018	2019	2018
Interest income	$ 525	$ 277	$ 1,179	$ 669
Other income (expense), net	1,656	69	1,184	(163)
Other income, net	$ 2,181	$ 346	$ 2,363	$ 506

8. Debt

The following table summarizes our debt balances and the related weighted average effective interest rates, which includes the effect of interest rate swap agreements.

	Debt balance at		Weighted average effective interest rate at	
(dollars in thousands)	June 30, 2019	December 31, 2018	June 30, 2019	December 31, 2018
Credit facility:				
Revolving credit loans	$ 277,700	$ 100,000	3.92%	4.13%
Term loans	285,000	288,750	3.65%	3.44%
Total debt	562,700	388,750	3.78%	3.61%
Less: Unamortized discount and debt issuance costs	1,388	1,626		
Less: Debt, current portion	7,500	7,500	3.90%	3.77%
Debt, net of current portion	$ 553,812	$ 379,624	3.78%	3.61%

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

In June 2017, we entered into a five-year $700.0 million senior credit facility (the "2017 Credit Facility"). As of June 30, 2019, the required annual maturities related to the 2017 Credit Facility were as follows:

Years ending December 31, (dollars in thousands)		Annual maturities
2019 - remaining	$	3,750
2020		7,500
2021		7,500
2022		543,950
2023		—
Thereafter		—
Total required maturities	$	562,700

Financing for 2019 acquisition

On January 2, 2019, we acquired YourCause for $157.7 million in cash, subject to certain adjustments set forth in the agreement and plan of merger. We financed the acquisition with a revolving credit loan under the 2017 Credit Facility.

9. Derivative Instruments

Cash flow hedges

We generally use derivative instruments to manage our variable interest rate risk. In July 2017, we entered into an interest rate swap agreement (the "July 2017 Swap Agreement"), which effectively converts portions of our variable rate debt under the 2017 Credit Facility to a fixed rate for the term of the July 2017 Swap Agreement. The notional value of the July 2017 Swap Agreement was $150.0 million with an effective date beginning in July 2017 through July 2021. We designated the July 2017 Swap Agreement as a cash flow hedge at the inception of the contract.

In February 2018, we entered into an additional interest rate swap agreement (the "February 2018 Swap Agreement"), which effectively converts portions of our variable rate debt under the 2017 Credit Facility to a fixed rate for the term of the February 2018 Swap Agreement. The notional value of the February 2018 Swap Agreement was $50.0 million with an effective date beginning in February 2018 through June 2021. We designated the February 2018 Swap Agreement as a cash flow hedge at the inception of the contract.

In June 2019, we entered into an additional interest rate swap agreement (the "June 2019 Swap Agreement"), which effectively converts portions of our variable rate debt under the 2017 Credit Facility to a fixed rate for the term of the June 2019 Swap Agreement. The notional value of the June 2019 Swap Agreement was $75.0 million with an effective date beginning in June 2019 through June 2021. We designated the June 2019 Swap Agreement as a cash flow hedge at the inception of the contract.

The fair values of our derivative instruments were as follows as of:

	Asset Derivatives					Liability Derivatives				
(dollars in thousands)	Balance sheet location		June 30, 2019		December 31, 2018	Balance sheet location		June 30, 2019		December 31, 2018
Derivative instruments designated as hedging instruments:										
Interest rate swaps, long-term portion	Other assets		—		2,260	Other liabilities		1,826		186
Total derivative instruments designated as hedging instruments		$	—	$	2,260		$	1,826	$	186

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

The effects of derivative instruments in cash flow hedging relationships were as follows:

(dollars in thousands)	Gain (loss) recognized in accumulated other comprehensive loss as of June 30, 2019	Location of gain (loss) reclassified from accumulated other comprehensive loss into income	Gain (loss) reclassified from accumulated other comprehensive loss into income: Three months ended June 30, 2019	Six months ended June 30, 2019
Interest rate swaps	$ (1,826)	Interest expense	$ 244	$ 473
	June 30, 2018		Three months ended June 30, 2018	Six months ended June 30, 2018
Interest rate swaps	$ 3,789	Interest expense	$ (60)	$ (40)

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. Accumulated other comprehensive income (loss) includes unrealized gains or losses from the change in fair value measurement of our derivative instruments each reporting period and the related income tax expense or benefit. Changes in the fair value measurements of the derivative instruments and the related income tax expense or benefit are reflected as adjustments to accumulated other comprehensive income (loss) until the actual hedged expense is incurred or until the hedge is terminated at which point the unrealized gain (loss) is reclassified from accumulated other comprehensive income (loss) to current earnings. The estimated accumulated other comprehensive income as of June 30, 2019 that is expected to be reclassified into earnings within the next twelve months is insignificant. There were no ineffective portions of our interest rate swap derivatives during the six months ended June 30, 2019 and 2018. See Note 13 to these consolidated financial statements for a summary of the changes in accumulated other comprehensive income (loss) by component.

10. Commitments and Contingencies

Leases

We have operating leases for corporate offices, subleased offices and certain equipment and furniture. Our leases have remaining lease terms of less than 1 year to 19 years, some of which include options to extend the leases for up to 5 years. We do not have lease agreements with residual value guarantees, sale leaseback terms or material restrictive covenants.

In May 2016, we entered into a lease agreement for our New Headquarters Facility in Charleston, South Carolina. There are two phases for construction of the New Headquarters Facility. Phase One included a building with approximately 172,000 rentable square feet, which we began using in April 2018. 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. The lease agreement expires in April 2038 and provides for four renewal periods of five years each at a base rent equal to the then prevailing market rate for comparable buildings.

We continue to lease our former headquarters facility, now called our Customer Operations Center, in Charleston, South Carolina. The lease expires in October 2023 and has two five-year renewal options. We also have a lease for office space in Austin, Texas which expires in September 2023 and has two five-year renewal options.

For each of the leases discussed above, we have not included the renewal options in the lease terms for calculating the lease liability as the renewal options allow us to maintain operational flexibility and we are not reasonably certain we will exercise these options at this time.

As of June 30, 2019, we had additional operating leases, primarily for office space, that have not yet commenced with future rent payments of $6.5 million. These operating leases will commence during fiscal year 2019 with lease terms of two years.

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

The components of lease expense for the three and six months ended June 30, 2019, were as follows:

(dollars in thousands)	Three months ended June 30, 2019	Six months ended June 30, 2019
Operating lease cost(1)	$ 5,894	$ 11,894
Variable lease cost	988	1,979
Sublease income	(755)	(1,459)
Net lease cost	$ 6,127	$ 12,414

(1) Includes short-term lease costs, which were immaterial.

During the six months ended June 30, 2019, we recorded $1.3 million in impairments of operating lease ROU assets associated with certain leased office spaces we ceased using as part of our facilities optimization restructuring. These impairments were recorded as restructuring expense on our consolidated statements of comprehensive income. See Note 15 to these consolidated financial statements for additional details regarding our facilities optimization restructuring.

Total rent expense as determined under ASC 840 for the three and six months ended June 30, 2018 was $5.5 million and $9.9 million, respectively.

Maturities of our operating lease liabilities as of June 30, 2019 were as follows:

Years ending December 31, (dollars in thousands)	Operating leases(1)
2019 – remaining	$ 11,376
2020	21,672
2021	18,948
2022	16,823
2023	14,608
Thereafter	81,958
Total lease payments	165,385
Less: Amount representing interest	49,114
Present value of future payments	$ 116,271

(1) Our maturities of our operating lease liabilities do not include payments related to Phase Two of our New Headquarters Facility, as that option had not been exercised as of June 30, 2019.

As determined under ASC 840, the future minimum lease payments related to lease agreements with a remaining noncancelable term in excess of one year, net of related sublease commitments and lease incentives, as of December 31, 2018 were as follows:

Years ending December 31, (dollars in thousands)	Operating leases
2019	$ 20,808
2020	20,274
2021	16,924
2022	14,391
2023	12,923
Thereafter	81,755
Total minimum lease payments	$ 167,075

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

Our ROU assets and lease liabilities are included in the following line items in our consolidated balance sheet:

(dollars in thousands)		June 30, 2019
Operating leases		
Operating lease right-of-use assets	$	107,165
Accrued expenses and other current liabilities	$	16,155
Operating lease liabilities, net of current portion		100,116
Total operating lease liabilities	$	116,271

As of June 30, 2019, the weighted average remaining lease terms and discount rates were as follows:

(dollars in thousands)	June 30, 2019
Operating leases	
Weighted average remaining lease term (years)	13.0
Weighted average discount rate	5.96%

Supplemental cash flow information related to leases during the six months ended June 30, 2019, was as follows:

		Six months ended June 30,
(dollars in thousands)		2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	$	11,673
Right-of-use assets obtained in exchange for lease obligations (non-cash):		
Operating leases	$	105,010

Other commitments

The term loans under the 2017 Credit Facility 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.

We have contractual obligations for third-party technology used in our solutions and for other services we purchase as part of our normal operations. In certain cases, these arrangements require a minimum annual purchase commitment by us. As of June 30, 2019, the remaining aggregate minimum purchase commitment under these arrangements was approximately $106.5 million through 2023.

Solution and service indemnifications

In the ordinary course of business, we provide certain indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our solutions or services. If we determine that it is probable that a loss has been incurred related to solution or service indemnifications, any such loss that could be reasonably estimated would be recognized. We have not identified any losses and, accordingly, we have not recorded a liability related to these indemnifications.

Legal proceedings

We are subject to legal proceedings and claims that arise in the ordinary course of business. We make a provision for a loss contingency when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in this note, we have determined as of June 30, 2019, that no provision for liability nor disclosure is required related to any claim against us because (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, results of operations or cash flows could be negatively affected in any particular period by an unfavorable resolution of one or more of such proceedings, claims or investigations.

11. Income Taxes

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

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2019	2018	2019	2018
Income tax provision (benefit)	$ 2,733	$ 825	$ 899	$ (2,702)
Effective income tax rate	27.7%	11.1%	13.0%	(12.5)%

The increase in our effective income tax rate during the three and six months ended June 30, 2019, when compared to the same periods in 2018, was primarily due to a decrease in the discrete benefit to income tax expense relating to stock-based compensation. The impact was attributable to a decrease in the market price for shares of our common stock, when compared to the same periods in 2018, as reported by the Nasdaq Stock Market LLC ("Nasdaq"). Most of our equity awards are granted during our first quarter and vest in subsequent years during the same quarter.

12. Stock-based Compensation

Stock-based compensation expense is allocated to cost of revenue and operating expenses on the consolidated statements of comprehensive income based on where the associated employee’s compensation is recorded. The following table summarizes stock-based compensation expense:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2019	2018	2019	2018
Included in cost of revenue:				
Cost of recurring	$ 451	$ 718	$ 963	$ 1,170
Cost of one-time services and other	340	927	802	1,570
Total included in cost of revenue	791	1,645	1,765	2,740
Included in operating expenses:				
Sales, marketing and customer success	2,827	2,807	5,738	4,632
Research and development	2,753	2,448	5,427	4,584
General and administrative	8,658	6,961	15,825	12,997
Total included in operating expenses	14,238	12,216	26,990	22,213
Total stock-based compensation expense	$ 15,029	$ 13,861	$ 28,755	$ 24,953

13. Stockholders' Equity

Dividends

Our Board of Directors has adopted a dividend policy, which provides for the distribution to stockholders of a portion of cash generated by us that is in excess of operational needs and capital expenditures. The 2017 Credit Facility limits the amount of dividends payable and certain state laws restrict the amount of dividends distributed.

In February 2019, our Board of Directors approved an annual dividend rate of $0.48 per share to be made in quarterly payments. 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. The following table provides information with respect to quarterly dividends of $0.12 per share paid on common stock during the six months ended June 30, 2019.

Declaration Date	Dividend per Share	Record Date	Payable Date
February 6, 2019	$ 0.12	February 27	March 15
April 30, 2019	$ 0.12	May 28	June 14

On July 30, 2019, our Board of Directors declared a third quarter dividend of $0.12 per share payable on September 13, 2019 to stockholders of record on August 28, 2019.

Changes in accumulated other comprehensive income (loss) by component

The changes in accumulated other comprehensive income (loss) by component, consisted of the following:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2019	2018	2019	2018
Accumulated other comprehensive (loss) income, beginning of period	$ (1,452)	$ 7,041	$ (5,110)	$ (642)
By component:				
Gains and losses on cash flow hedges:				
Accumulated other comprehensive income balance, beginning of period	$ 566	$ 1,994	$ 1,498	$ 748
Other comprehensive (loss) income before reclassifications, net of tax effects of $628, $(259), $904 and $(651)	(1,759)	721	(2,522)	1,815
Amounts reclassified from accumulated other comprehensive loss to interest expense	(244)	60	(473)	40
Tax benefit included in provision for income taxes	64	(16)	124	(11)
Total amounts reclassified from accumulated other comprehensive loss	(180)	44	(349)	29
Net current-period other comprehensive (loss) income	(1,939)	765	(2,871)	1,844
Reclassification upon early adoption of ASU 2018-02	—	—	—	167
Accumulated other comprehensive (loss) income balance, end of period	$ (1,373)	$ 2,759	$ (1,373)	$ 2,759
Foreign currency translation adjustment:				
Accumulated other comprehensive (loss) income balance, beginning of period	$ (2,018)	$ 5,047	$ (6,608)	$ (1,390)
Translation adjustments	(6,018)	(8,817)	(1,428)	(2,380)
Accumulated other comprehensive loss balance, end of period	(8,036)	(3,770)	(8,036)	(3,770)
Accumulated other comprehensive loss, end of period	$ (9,409)	$ (1,011)	$ (9,409)	$ (1,011)

14. Revenue Recognition

Transaction price allocated to the remaining performance obligations

As of June 30, 2019, approximately $797 million of revenue is expected to be recognized from remaining performance obligations. We expect to recognize revenue on approximately 60% of these remaining performance obligations over the next 12 months, with the remainder recognized thereafter.

We applied the practical expedient in ASC 606-10-50-14 and have excluded the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less (one-time services); and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed (payment services and usage).

Contract balances

Our contract assets as of June 30, 2019 and December 31, 2018 were insignificant. Our opening and closing balances of deferred revenue were as follows:

(in thousands)	June 30, 2019	December 31, 2018
Total deferred revenue	$ 329,623	$ 298,555

The increase in deferred revenue during the six months ended June 30, 2019 was primarily due to new subscription sales of our cloud-based solutions and a seasonal increase in customer contract renewals. Historically, due to the timing of customer budget cycles, we have an increase in customer contract renewals at or near the beginning of our third quarter. Our acquisition of YourCause on January 2, 2019 has also modestly contributed to the increase in deferred revenue since December 31, 2018. The amount of revenue recognized during the six months ended June 30, 2019 that was included in the deferred revenue balance at the beginning of the period was approximately $220 million. The amount of revenue recognized during the six months ended June 30, 2019 from performance obligations satisfied in prior periods was insignificant.

Disaggregation of revenue

We sell our cloud-based solutions and related services in two primary geographical markets: to customers in the United States, and to customers located outside of the United States. The following table presents our revenue by geographic area based on the address of our customers:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2019	2018	2019	2018
United States	$ 190,399	$ 179,586	$ 378,525	$ 355,509
Other countries	35,235	34,086	62,939	62,347
Total revenue	$ 225,634	$ 213,672	$ 441,464	$ 417,856

The General Markets Group ("GMG"), the Enterprise Markets Group ("EMG"), and the International Markets Group ("IMG") comprise our go-to-market organizations. The following is a description of each market group:

- The GMG focuses on sales primarily to all K-12 private schools, faith-based and arts and cultural organizations, as well as emerging and mid-sized prospects in the U.S.;
- The EMG focuses on sales primarily to all healthcare and higher education institutions, corporations and foundations, as well as large and/or strategic prospects in the U.S.; and
- The IMG focuses on sales primarily to all prospects and customers outside of the U.S.

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

The following table presents our revenue by market group:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2019	2018(2)	2019	2018(2)
GMG	$ 93,259	$ 89,341	$ 185,774	$ 177,609
EMG(1)	96,710	89,590	191,875	176,441
IMG	35,614	34,649	63,736	63,648
Other	51	92	79	158
Total revenue	$ 225,634	$ 213,672	$ 441,464	$ 417,856

(1) The operating results of YourCause have been included in EMG from the date of acquisition. See Note 3 to these consolidated financial statements for details regarding this acquisition.
(2) Beginning in the first quarter of 2019, all of our Canadian operations are included in IMG. We have recast our revenue by market group for the three and six months ended June 30, 2018, to present them on a consistent basis with the current year.

15. 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 prior to our adoption of ASU 2016-02 on January 1, 2019 consisted primarily of costs to terminate 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 facilities-related fixed assets that we would no longer use.

Upon adoption of ASU 2016-02 at January 1, 2019, we reduced our operating lease ROU assets recognized at transition by the carrying amounts of the restructuring liabilities for certain leased office spaces that we ceased using prior to December 31, 2018. See additional details below.

Restructuring costs incurred during the six months ended June 30, 2019 consisted primarily of operating lease ROU asset impairment costs and, to a lesser extent, lease payments for offices we have ceased using and write-offs of facilities-related fixed 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 $8.1 million has been incurred as of June 30, 2019, with substantially all of the remaining costs expected to be incurred by the end of 2019.

The following table summarizes our facilities optimization restructuring costs as of June 30, 2019:

(in thousands)	Cumulative costs incurred as of December 31, 2018	Costs incurred during the three months ended	Costs incurred during the six months ended(1)	Cumulative costs incurred as of June 30, 2019
By component:				
Contract termination costs	$ 4,176	$ 527	$ 1,918	$ 6,094
Other costs	1,208	203	765	1,973
Total	$ 5,384	$ 730	$ 2,683	$ 8,067

(1) Includes $1.3 million of operating lease ROU asset impairment costs.

The change in our liability related to our facilities optimization restructuring during the six months ended June 30, 2019, consisted of the following:

(in thousands)	Accrued at December 31, 2018	Increases for incurred costs(1)	Written off upon adoption of ASU 2016-02(2)	Costs paid	Accrued at June 30, 2019
By component:					
Contract termination costs	$ 1,865	$ 1,918	$ (1,656)	$ (2,127)	$ —
Other costs	50	765	—	(794)	21
Total	$ 1,915	$ 2,683	$ (1,656)	$ (2,921)	$ 21

(1) Includes $1.3 million of operating lease ROU asset impairment costs.
(2) Upon adoption of ASU 2016-02 at January 1, 2019, we reduced our operating lease ROU assets recognized at transition by the carrying amounts of the restructuring liabilities for certain leased office spaces that we ceased using prior to December 31, 2018.

ITEM 2. 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 our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. 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.

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 2019, we have continued to execute on our four-point growth strategy targeted to drive solution and service innovation, quality enhancement, increasing operating efficiency and financial performance:

Four-Point Growth Strategy

1. *Deliver Integrated and Open Solutions in the Cloud*

   The early adopter program for our Cloud Solution for Faith Communities is on track and we expect to soon announce the general availability of Blackbaud Church Management™. Our goal is to enable churches to digitally improve their day-to-day operations through a single, connected experience. We've spent a considerable amount of time working with churches to fully understand their processes and workflows to gain additional insight into the capabilities they need to be successful, and we continue to incorporate that feedback to optimize our platform specifically for their needs. We have heard from our early adopter customers that our solution stands out as intuitive and easy-to-use with a mobile responsive user experience. Churches can also add other Blackbaud capabilities from the Cloud Solution for Faith Communities as their needs scale—all through one integrated experience, which is powered by the Blackbaud SKY platform. Bringing this solution to market is a significant step toward addressing several challenges in the church market and a substantial opportunity for Blackbaud.

   During the second quarter of 2019, we continued to progress in the U.S. rollout of Blackbaud Peer-to-Peer Fundraising, powered by JustGiving. This new solution enables all social good organizations to empower supporters to fundraise on their behalf. We're excited about the opportunity to disrupt the market landscape by providing this peer-to-peer solution, which is fully integrated across our portfolio of best-in-class cloud solutions. The market response to this new solution has been positive, with a growing number of customers going live with active campaigns.

2. *Drive Sales Effectiveness*

   We spent much of 2018 working to simplify our sales program and refine our methodology and approach in a uniform way to better enable our salespeople with process and practice. With the sales structure transformation now largely done, our focus is on adding additional sales headcount and improving overall productivity. Our plan calls for a continuation of our heightened level of sales hiring, which we expect to enable us to pursue the large opportunities we have across our vertical markets. Our account executives continue to lead with total solution selling by vertical, focused on recurring revenue and driving more products per customer, higher ASPs and overall increased customer lifetime value. We also continue to rapidly advance our existing applications and bring new solutions to market, enabling our sales teams to sell more.

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

   In January 2019, we completed our acquisition of YourCause, an industry leader in enterprise corporate social responsibility and employee engagement technology, and we continue to be excited about this business. Adding YourCause's capabilities in workplace giving and volunteering to Blackbaud's cloud software platform, data intelligence, services and expertise in philanthropy and engagement is expected to drive connectivity and efficiencies for companies and the broader social good community. Since January, we have moved quickly on back-office integration so we can focus on the opportunity ahead of us, which is significant given the trend in institutions of all sizes focusing on corporate social responsibility. Our TAM now stands at over $10 billion, and we remain active in the evaluation of opportunities to further expand our addressable market through acquisitions and internal product development.

4. *Improve Operating Efficiency*

   We are focused on operational efficiency to strengthen the business and position us for long-term success. This continuous effort spans the entire organization as we drive towards a more scalable operating model that creates efficiency and consistency in how we execute through infrastructure investments, productivity initiatives, and organizational re-alignments. One example is our recent heightened investments in sales hiring. We have spent the last several years creating one global sales operating model, which allows us to recruit, hire, train and track the progress of a growing sales team in a way we could not have done in the past. In addition, we have continued executing against our workplace strategy, working to replace and upgrade some of our existing offices and expand our footprint into new locations for customer facing roles. This has been a multi-year program for us, and we expect to be largely complete by the end of 2019.

Total revenue

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2019	2018	Change	2019	2018	Change
Total revenue	$ 225.6	$ 213.7	5.6%	$ 441.5	$ 417.9	5.6%

The increases in total revenue during the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily driven by growth in recurring revenue as we continue to see positive demand from customers across our portfolio of cloud-based solutions. Our acquisitions of Reeher and YourCause, which occurred after March 31, 2018, also contributed to the increases in recurring and total revenue. As expected, one-time services and other revenue declined $3.8 million and $9.4 million, respectively, during the three and six months ended June 30, 2019 due to our continued shift in focus towards selling cloud-based subscription solutions. In general, our cloud-based solutions include integrated analytics, training and payments services, and require less implementation services and little to no customization services. We are also selling more subscription-based contracts for retained services and services embedded in our renewable cloud-based solution contracts. As a result, we continue to expect one-time services and other revenue to decline.

Income from operations

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2019	2018	Change	2019	2018	Change
Income from operations	$ 13.5	$ 11.4	18.6%	$ 15.7	$ 29.0	(45.9)%

Income from operations increased during the three months ended June 30, 2019, when compared to the same period in 2018. The positive impact of growth in total revenue driven by recurring subscriptions was partially 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 $1.2 million and amortization of intangible assets from business combinations of $0.6 million, also negatively impacted income from operations during the three months ended June 30, 2019.

Income from operations decreased during the six months ended June 30, 2019, when compared to the same period in 2018. Our growth in total revenue driven by recurring subscriptions was offset primarily by investments we are making in our sales organization and innovation. Increases in stock-based compensation of $3.8 million, employee severance of $2.6 million, rent expense of $1.6 million and amortization of intangible assets from business combinations of $1.7 million, also negatively impacted income from operations during the six months ended June 30, 2019. 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 the first quarter of 2019, when compared to the grant date fair value of the awards granted during the same period in 2018. The increase in employee severance was related to the elimination of certain roles within the company. The increase in rent expense was primarily associated with the lease for our New Headquarters Facility in Charleston, South Carolina, which commenced in April 2018.

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. For the twelve months ended June 30, 2019, approximately 92% of our customers with recurring revenue contracts were retained. This customer retention rate is unchanged from our rate for the full year ended December 31, 2018.

Balance sheet and cash flow

At June 30, 2019, our cash and cash equivalents were $32.7 million and the carrying amount of our debt under the 2017 Credit Facility was $561.3 million. Our net leverage ratio was 2.74 to 1.00.

During the six months ended June 30, 2019, we generated $45.1 million in cash from operations, had a net increase in our borrowings of $174.0 million, which was primarily used to finance the acquisition of YourCause, returned $11.8 million to stockholders by way of dividends and had aggregate cash outlays of $29.6 million for purchases of property and equipment and capitalized software development costs.

Adoption of new lease accounting standard

On January 1, 2019, we adopted ASU 2016-02, using the transition method that allowed us to initially apply the guidance at the adoption date of January 1, 2019 without adjusting comparative periods presented. Adopting ASU 2016-02 had a material impact on our consolidated balance sheet as we recognized lease liabilities and ROU assets for those leases classified as operating leases. The impacts of adoption are reflected in the financial information herein. For additional information regarding the impact of our adoption of ASU 2016-02, see Notes 2 and 10 of our consolidated financial statements in this report.

Results of Operations

Comparison of the three and six months ended June 30, 2019 and 2018

We have included the results of operations of YourCause in our consolidated results of operations from the date of acquisition. We determined that the YourCause acquisition was not a material business combination; therefore, separate presentation of revenue and earnings since the acquisition date are not required nor included herein.

Operating results

Recurring revenue

(dollars in millions)	Three months ended June 30, 2019	2018	Change	Six months ended June 30, 2019	2018	Change
Recurring revenue	$ 208.5	$ 192.7	8.2%	$ 406.6	$ 373.6	8.8%
Cost of recurring	86.7	76.4	13.5%	171.4	145.4	17.8%
Recurring gross profit(1)	$ 121.8	$ 116.4	4.6%	$ 235.2	$ 228.2	3.1%
Recurring gross margin	58.4%	60.4%		57.8%	61.1%	

(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 retained 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.

The increases in recurring revenue during the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily due to positive demand across our portfolio of cloud-based solutions as revenue from subscriptions increased $20.4 million and $42.2 million, respectively. The inclusion of Reeher and YourCause contributed to the increases in recurring revenue as both acquisitions were completed after March 31, 2018. We also saw increases in revenue from subscription-based retained services as well as services embedded in our renewable cloud-based solution contracts. These favorable impacts from subscriptions were partially offset by decreases in maintenance revenue of $4.7 million and $9.2 million, respectively during the three and six months ended June 30, 2019, when compared to the same periods in 2018. The decreases in maintenance revenue were primarily related to our efforts to migrate customers from legacy on-premises solutions onto our solutions powered by Blackbaud SKY, our modern cloud platform.

The increases in cost of recurring revenue during the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily due to increases in transaction-based costs of $2.2 million and $6.5 million, respectively, related to payment services integrated in our cloud-based solutions, compensation costs of $2.0 million and $4.4 million, respectively, hosting costs and data center costs of $1.0 million and $2.9 million, respectively, allocations of depreciation, facilities and IT support costs of $0.9 million and $3.4 million, respectively and amortization of software development costs of $0.9 million and $1.9 million, respectively. The growth in compensation costs was primarily attributable to an increasing portion of our resources now providing subscription-based retained services as opposed to one-time. The inclusion of Reeher and YourCause also contributed to the increases in cost of recurring revenue during the three and six months ended June 30, 2019 when compared to the same periods in 2018. 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 decreases in recurring gross margin for the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily the result of incremental costs associated with our continued shift toward cloud-based solutions, including hosting and data center costs, compensation costs and amortization of software development costs. Also contributing to the decrease in recurring gross margin for the six months ended June 30, 2019 was a one-time third-party refund related to our integrated payment services during the three months ended March 31, 2018 that did not recur in 2019.

One-time services and other revenue

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2019	2018	Change	2019	2018	Change
One-time services and other revenue	$ 17.2	$ 20.9	(18.0)%	$ 34.9	$ 44.3	(21.1)%
Cost of one-time services and other	14.2	18.8	(24.8)%	28.7	37.8	(24.0)%
One-time services and other gross profit(1)	$ 3.0	$ 2.1	43.6 %	$ 6.2	$ 6.5	(4.6)%
One-time services and other gross margin	17.6%	10.0%		17.7%	14.6%	

(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.

One-time services and other revenue decreased during the three and six months ended June 30, 2019, when compared to the same periods in 2018, primarily due to decreases in one-time consulting revenue of $2.4 million and $6.2 million, respectively and analytics revenue of $0.9 million and $1.9 million, respectively. We expect that the 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 also continue to sell more subscription-based contracts for retained services and services embedded in our renewable cloud-based solution contracts, both of which are recorded as recurring revenue.

Cost of one-time services and other decreased during the three and six months ended June 30, 2019, when compared to the same periods in 2018, primarily due to a decrease in compensation costs of $3.3 million and $6.3 million, respectively, which is in line with the ongoing shift in our go-to-market strategy as discussed above as an increasing portion of our resources are now providing subscription-based retained services as opposed to one-time.

One-time services and other gross margin increased during the three and six months ended June 30, 2019, when compared to the same periods in 2018, as the reductions in costs of one-time services and other discussed above outpaced the declines in one-time consulting revenue and higher margin analytics revenue associated with the shift in our go-to-market strategy.

Operating expenses

Sales, marketing and customer success

(dollars in millions)	Three months ended June 30, 2019	2018	Change	Six months ended June 30, 2019	2018	Change
Sales, marketing and customer success expense	$ 55.0	$ 48.5	13.4%	$ 110.5	$ 94.0	17.6%
% of total revenue	24.4%	22.7%		25.0%	22.5%	

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

We continue to make investments to drive sales effectiveness, which is a component of our four-point growth strategy. The increases in sales, marketing and customer success expense in dollars and as a percentage of total revenue during the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily due to increases in compensation costs of $4.8 million and $11.3 million, respectively. Also contributing to the increase in sales, marketing and customer success expense during the six months ended June 30, 2019, when compared to the same period in 2018, was an increase in commissions expense of $1.8 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 investments during the remainder of 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 Reeher and YourCause. The increase in commission expense was primarily driven by an increase in commissionable sales.

Research and development

(dollars in millions)	Three months ended June 30, 2019(1)	2018(1)	Change	Six months ended June 30, 2019(2)	2018(2)	Change
Research and development expense	$ 25.9	$ 25.3	2.4%	$ 54.4	$ 51.3	6.1%
% of total revenue	11.5%	11.8%		12.3%	12.3%	

(1) Not included in research and development expense for the three months ended June 30, 2019 and 2018 were $11.7 million and $9.2 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. 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.

(2) Not included in research and development expense for the six months ended June 30, 2019 and 2018 were $22.8 million and $16.1 million, respectively, of qualifying costs associated with development activities that are required to be capitalized under the internal-use software accounting guidance.

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, upgrading and enhancing existing solutions, and allocated depreciation, facilities and IT support costs.

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 increases in research and development expense during the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily due to increases in compensation costs of $2.5 million and $5.8 million, respectively. The increases in compensation costs were primarily associated with the inclusion of Reeher's and YourCause's engineering resources. The increase in research and development expense 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. 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.

General and administrative

(dollars in millions)	Three months ended June 30, 2019	2018	Change	Six months ended June 30, 2019	2018	Change
General and administrative expense	$ 28.5	$ 28.4	0.3%	$ 55.7	$ 53.5	4.0%
% of total revenue	12.7%	13.3%		12.6%	12.8%	

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, cybersecurity, allocated depreciation, facilities and IT support costs, acquisition-related expenses and other administrative expenses.

The increase in general and administrative expense during the six months ended June 30, 2019, when compared to the same period in 2018, was primarily due to increases in compensation costs of $3.5 million and rent expense of $1.6 million, partially offset by a decrease in acquisition-related expenses and integration costs of $2.2 million. The increase in compensation costs was primarily related to stock-based compensation and our acquisition of YourCause. The increase in rent expense was related to the lease of our New Headquarters Facility in Charleston, South Carolina, which commenced in April 2018.

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 prior to our adoption of ASU 2016-02 on January 1, 2019 consisted primarily of costs to terminate 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 facilities-related fixed assets that we would no longer use.

Upon adoption of ASU 2016-02 at January 1, 2019, we reduced our operating lease ROU assets recognized at transition by the carrying amounts of the restructuring liabilities for certain leased office spaces that we ceased using prior to December 31, 2018. See additional details below.

Restructuring costs incurred during the six months ended June 30, 2019 consisted primarily of operating lease ROU asset impairment costs and, to a lesser extent, lease payments for offices we have ceased using and write-offs of facilities-related fixed 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 $8.1 million has been incurred as of June 30, 2019, with substantially all of the remaining costs expected to be incurred by the end of 2019. 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 June 30, 2019:

(in thousands)	Cumulative costs incurred as of December 31, 2018	Costs incurred during the three months ended	Costs incurred during the six months ended(1)	Cumulative costs incurred as of June 30, 2019
By component:				
Contract termination costs	$ 4,176	$ 527	$ 1,918	$ 6,094
Other costs	1,208	203	765	1,973
Total	$ 5,384	$ 730	$ 2,683	$ 8,067

(1) Includes $1.3 million of operating lease ROU asset impairment costs.

The change in our liability related to our facilities optimization restructuring during the six months ended June 30, 2019, consisted of the following:

(in thousands)	Accrued at December 31, 2018	Increases for incurred costs(1)	Written off upon adoption of ASU 2016-02(2)	Costs paid	Accrued at June 30, 2019
By component:					
Contract termination costs	$ 1,865	$ 1,918	$ (1,656)	$ (2,127)	$ —
Other costs	50	765	—	(794)	21
Total	$ 1,915	$ 2,683	$ (1,656)	$ (2,921)	$ 21

(1) Includes $1.3 million of operating lease ROU asset impairment costs.
(2) Upon adoption of ASU 2016-02 at January 1, 2019, we reduced our operating lease ROU assets recognized at transition by the carrying amounts of the restructuring liabilities for certain leased office spaces that we ceased using prior to December 31, 2018.

Interest expense

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2019	2018	Change	2019	2018	Change
Interest expense	$ 5.8	$ 4.3	34.8%	$ 11.1	$ 7.8	42.2%
% of total revenue	2.6%	2.0%		2.5%	1.9%	

The increases in interest expense in dollars and as a percentage of total revenue during the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily due to increases in our average daily borrowings related to our acquisition of YourCause in January 2019. Also contributing to the increases in interest expense during the three and six months ended June 30, 2019 were modest increases in our weighted average effective interest rates.

Deferred revenue

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

(dollars in millions)	Timing of recognition	June 30, 2019	Change	December 31, 2018
Recurring	Over the period billed in advance, generally one year	$ 314.7	9.7 %	$ 287.0
One-time services and other	As services are delivered	14.9	28.9 %	11.6
Total deferred revenue(1)		329.6	10.4 %	298.6
Less: Long-term portion		2.3	(9.4)%	2.6
Current portion(1)		$ 327.3	10.6 %	$ 296.0

(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 the six months ended June 30, 2019, primarily due to new subscription sales of our cloud-based solutions and a seasonal increase in customer contract renewals. Historically, due to the timing of customer budget cycles, we have an increase in customer contract renewals at or near the beginning of our third quarter. Our acquisition of YourCause on January 2, 2019 has also modestly contributed to the increase in deferred revenue from recurring revenue contracts since December 31, 2018. Deferred revenue from one-time services and other increased during the six months ended June 30, 2019, primarily due to a seasonal increase in advance registration billings associated with our bbcon user conference, which occurs each year in October.

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".

Income tax provision (benefit)

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2019	2018	Change	2019	2018	Change
Income tax provision (benefit)	$ 2.7	$ 0.8	231.3%	$ 0.9	$ (2.7)	(133.3)%
Effective income tax rate	27.7%	11.1%		13.0%	(12.5)%	

The increases in our effective income tax rate during the three and six months ended June 30, 2019, when compared to the same periods in 2018, were primarily due to a decrease in the discrete benefit to income tax expense relating to stock-based compensation. The impact was attributable to a decrease in the market price for shares of our common stock, when compared to the same periods in 2018, as reported by Nasdaq. Most of our equity awards are granted during our first quarter and vest in subsequent years during the same quarter.

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.

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2019	2018	Change	2019	2018	Change
GAAP Revenue	$ 225.6	$ 213.7	5.6 %	$ 441.5	$ 417.9	5.6 %
Non-GAAP adjustments:						
Add: Acquisition-related deferred revenue write-down	0.7	0.9	(22.1)%	1.4	1.3	13.0 %
Non-GAAP revenue(1)	$ 226.4	$ 214.6	5.5 %	$ 442.9	$ 419.1	5.7 %
GAAP gross profit	$ 124.8	$ 118.5	5.3 %	$ 241.4	$ 234.6	2.9 %
GAAP gross margin	55.3%	55.5%		54.7%	56.2%	
Non-GAAP adjustments:						
Add: Acquisition-related deferred revenue write-down	0.7	0.9	(22.1)%	1.4	1.3	13.0 %
Add: Stock-based compensation expense	0.8	1.6	(51.9)%	1.8	2.7	(35.6)%
Add: Amortization of intangibles from business combinations	11.3	10.7	6.1 %	22.7	21.1	8.0 %
Add: Employee severance	—	—	(133.3)%	1.1	0.6	89.9 %
Subtotal(1)	12.8	13.3	(3.4)%	27.1	25.7	5.4 %
Non-GAAP gross profit(1)	$ 137.7	$ 131.8	4.5 %	$ 268.4	$ 260.3	3.1 %
Non-GAAP gross margin	60.8%	61.4%		60.6%	62.1%	

(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.

(dollars in millions, except per share amounts)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change	Six months ended June 30, 2019	Six months ended June 30, 2018	Change
GAAP income from operations	$ 13.5	$ 11.4	18.6 %	$ 15.7	$ 29.0	(45.9)%
GAAP operating margin	6.0%	5.3%		3.6%	6.9%	
Non-GAAP adjustments:						
Add: Acquisition-related deferred revenue write-down	0.7	0.9	(22.1)%	1.4	1.3	13.0 %
Add: Stock-based compensation expense	15.0	13.9	8.4 %	28.8	25.0	15.2 %
Add: Amortization of intangibles from business combinations	12.5	11.9	5.1 %	25.3	23.5	7.4 %
Add: Employee severance	0.2	0.1	91.0 %	3.6	1.0	250.3 %
Add: Acquisition-related integration costs	0.5	2.2	(78.9)%	1.2	2.6	(55.0)%
Add: Acquisition-related expenses	0.4	1.2	(69.9)%	0.8	1.6	(49.5)%
Add: Restructuring costs	0.7	3.7	(80.2)%	2.7	4.5	(40.4)%
Subtotal(1)	30.0	33.9	(11.4)%	63.7	59.5	7.1 %
Non-GAAP income from operations(1)	$ 43.5	$ 45.2	(3.9)%	$ 79.4	$ 88.5	(10.2)%
Non-GAAP operating margin	19.2%	21.1%		17.9%	21.1%	
GAAP income before provision for income taxes	$ 9.9	$ 7.4	33.1 %	$ 6.9	$ 21.6	(68.0)%
GAAP net income	$ 7.1	$ 6.6	8.3 %	$ 6.0	$ 24.3	(75.3)%
Shares used in computing GAAP diluted earnings per share	48,160,684	48,053,094	0.2 %	48,101,212	48,030,547	0.1 %
GAAP diluted earnings per share	$ 0.15	$ 0.14	7.1 %	$ 0.13	$ 0.51	(74.5)%
Non-GAAP adjustments:						
Add: GAAP income tax provision (benefit)	2.7	0.8	231.3 %	0.9	(2.7)	(133.3)%
Add: Total non-GAAP adjustments affecting income from operations	30.0	33.9	(11.4)%	63.7	59.5	7.1 %
Non-GAAP income before provision for income taxes	39.8	41.3	(3.4)%	70.7	81.2	(12.9)%
Assumed non-GAAP income tax provision(2)	8.0	8.3	(3.4)%	14.1	16.2	(12.9)%
Non-GAAP net income(1)	$ 31.9	$ 33.0	(3.4)%	$ 56.5	$ 64.9	(12.9)%
Shares used in computing non-GAAP diluted earnings per share	48,160,684	48,053,094	0.2 %	48,101,212	48,030,547	0.1 %
Non-GAAP diluted earnings per share	$ 0.66	$ 0.69	(4.3)%	$ 1.18	$ 1.35	(12.6)%

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

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.

(dollars in millions)	Six months ended June 30, 2019	Change	2018
GAAP net cash provided by operating activities	$ 45.1	(32.1)%	$ 66.4
Less: purchase of property and equipment	(6.4)	(33.4)%	(9.6)
Less: capitalized software development costs	(23.2)	41.9 %	(16.4)
Non-GAAP free cash flow	$ 15.5	(61.7)%	$ 40.5

Non-GAAP organic revenue growth

In addition, we discuss 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 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 our current business' organic revenue growth and revenue run-rate.

	Three months ended June 30,		Six months ended June 30,	
(dollars in millions)	2019	2018	2019	2018
GAAP revenue	$ 225.6	$ 213.7	$ 441.5	$ 417.9
GAAP revenue growth	**5.6%**		**5.6%**	
(Less) Add: Non-GAAP acquisition-related revenue (1)	(4.6)	1.8	(8.9)	4.5
Non-GAAP organic revenue	$ 221.1	$ 215.4	$ 432.5	$ 422.3
Non-GAAP organic revenue growth	**2.6%**		**2.4%**	
Non-GAAP organic revenue (2)	$ 221.1	$ 215.4	$ 432.5	$ 422.3
Foreign currency impact on Non-GAAP organic revenue (3)	2.2	—	4.0	—
Non-GAAP organic revenue on constant currency basis (3)	$ 223.3	$ 215.4	$ 436.5	$ 422.3
Non-GAAP organic revenue growth on constant currency basis	**3.6%**		**3.3%**	
GAAP recurring revenue	$ 208.5	$ 192.7	$ 406.6	$ 373.6
GAAP recurring revenue growth	**8.2%**		**8.8%**	
(Less) Add: Non-GAAP acquisition-related revenue (1)	(4.3)	1.7	(8.5)	4.3
Non-GAAP organic recurring revenue	$ 204.2	$ 194.5	$ 398.1	$ 377.9
Non-GAAP organic recurring revenue growth	**5.0%**		**5.3%**	

(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, if any, 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 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.

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 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:

(dollars in millions)	June 30, 2019	Change	December 31, 2018
Cash and cash equivalents	$ 32.7	5.8 %	$ 30.9
Property and equipment, net	39.6	(1.2)%	40.0
Software development costs, net	87.9	17.0 %	75.1
Total carrying value of debt	561.3	45.0 %	387.1
Working capital	(190.4)	8.3 %	(207.7)

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

	Six months ended June 30,		
(dollars in millions)	2019	Change	2018
Net cash provided by operating activities	$ 45.1	(32.1)%	$ 66.4
Net cash used in investing activities	(138.5)	94.3 %	(71.2)
Net cash provided by (used in) financing activities	30.8	(110.0)%	(309.1)

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.

At June 30, 2019, our total cash and cash equivalents balance included approximately $20.9 million of cash that was held by operations 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 the funds. We currently do not intend nor anticipate a need to repatriate our cash held outside the U.S.

Operating cash flow

Net cash provided by operating activities decreased by $21.3 million during the six months ended June 30, 2019, when compared to the same period in 2018, primarily due to a $8.6 million decrease in net income adjusted for non-cash expenses, and a decrease in cash flow from operations associated with working capital. Throughout both periods, 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, 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. Cash flow from operations associated with working capital decreased $12.7 million during the six months ended June 30, 2019, when compared to the same period in 2018, primarily due to an increase in the collection of customer account balances in 2018 from an aging improvement initiative. Fluctuations in the timing of vendor payments also contributed to the decrease in cash flow from operation associated with working capital.

Investing cash flow

Net cash used in investing activities of $138.5 million increased by $67.2 million during the six months ended June 30, 2019, when compared to the same period in 2018.

During the six months ended June 30, 2019, we used net cash of $109.4 million, for our acquisition of YourCause, compared to $45.3 million spent on similar investments during the same period in 2018. We used $23.2 million for software development costs, which was up $6.8 million from cash spent during the same period in 2018. 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 $6.4 million of cash for purchases of property and equipment during the six months ended June 30, 2019, which was down $3.2 million from cash spent during the same period in 2018. The higher cash outlays for property and equipment during the same period in 2018 was primarily driven by leasehold improvements for our New Headquarters Facility in Charleston, South Carolina.

Financing cash flow

During the six months ended June 30, 2019, we had a net increase in borrowings of $174.0 million, which was primarily used to finance our acquisition of YourCause.

We paid $19.8 million to satisfy tax obligations of employees upon settlement or exercise of equity awards during the six months ended June 30, 2019 compared to $25.2 million during the same period in 2018. 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. Most of our equity awards currently vest in our first quarter. In addition, during the six months ended June 30, 2019, we paid dividends of $11.8 million, which was relatively consistent with the comparable period of 2018.

Cash used in financing activities associated with changes in restricted cash due to customers increased $201.4 million during the six months ended June 30, 2019 when compared to the same period in 2018, 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 2018.

2017 Credit Facility

We have drawn on our credit facility from time to time to help us meet financial needs, such as financing for business acquisitions. At June 30, 2019, our available borrowing capacity under the 2017 Credit Facility was $119.0 million. The 2017 Credit Facility matures in June 2022.

At June 30, 2019, the carrying amount of our debt under the 2017 Credit Facility was $561.3 million. Our average daily borrowings during the three and six months ended June 30, 2019 were $585.1 million and $571.4 million, respectively.

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

Financial Covenant	Requirement	Ratio as of June 30, 2019
Net Leverage Ratio	≤ 3.50 to 1.00	2.74 to 1.00
Interest Coverage Ratio	≥ 2.50 to 1.00	10.12 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 June 30, 2019, we were in compliance with our debt covenants under the 2017 Credit Facility.

Commitments and contingencies

As of June 30, 2019, we had contractual obligations with future minimum commitments as follows:

	Payments due by period				
(in millions)	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Recorded contractual obligations:					
Debt(1)	$ 562.7	$ 7.5	$ 555.2	$ —	$ —
Interest payments on debt(2)	2.1	0.6	1.5	—	—
Operating leases(3)	165.4	22.5	38.0	27.2	77.6
Unrecorded contractual obligations:					
Interest payments on debt(4)	60.9	20.9	40.0	—	—
Purchase obligations(5)	106.5	44.0	61.7	0.8	—
Total contractual obligations	$ 897.5	$ 95.5	$ 696.4	$ 28.0	$ 77.6

(1) Represents principal payments only, under the following assumptions: (i) that the amounts outstanding under the 2017 Credit Facility at June 30, 2019 will remain outstanding until maturity, with minimum payments occurring as currently scheduled, and (ii) that there are no assumed future borrowings on the 2017 Credit Facility for the purposes of determining minimum commitment amounts.
(2) Represents interest payment obligations related to our interest rate swap agreements.
(3) Our commitments related to operating leases have not been reduced by sublease income, incentive payments and reimbursement of leasehold improvements.
(4) 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.
(5) We have contractual obligations for third-party technology used in our solutions and for other services 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 requires 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 June 30, 2019 and December 31, 2018, was $4.8 million and $3.7 million, respectively. Our accrued interest and penalties related to tax positions taken on our tax returns was $1.0 million and $0.7 million as of June 30, 2019 and December 31, 2018, 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 July 30, 2019, our Board of Directors declared a third quarter dividend of $0.12 per share payable on September 13, 2019 to stockholders of record on August 28, 2019.

Off-Balance Sheet Arrangements

As of June 30, 2019, 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 the six months ended June 30, 2019 was generated from operations outside the U.S. 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 accumulated other comprehensive loss as a component of stockholders' equity, was a loss of $8.0 million as of June 30, 2019 and a loss of $6.6 million as of December 31, 2018.

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 revenue and expenses denominated in non-U.S. currencies. During the six months ended June 30, 2019, foreign translation resulted in a decrease in our revenues and expenses denominated in non-U.S. currencies. Though we have exposure to fluctuations in currency exchange rates, primarily those between the U.S. dollar and both the British Pound and Canadian dollar, the impact has generally not been material to our consolidated results of operations or financial position. For the six months ended June 30, 2019, the fluctuation in foreign currency exchange rates reduced our total revenue by $3.8 million and our income from operations by $1.1 million. 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.

Critical Accounting Policies and Estimates

There have been no significant changes in our critical accounting policies and estimates during the six months ended June 30, 2019 as compared to those disclosed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K for the fiscal year ended December 31, 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.

ITEM 3. 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 June 30, 2019, we believe that the risk of exposure to changing interest rates for those positions is immaterial. There were no significant changes in how we manage interest rate risk between December 31, 2018 and June 30, 2019.

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 this report.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e) and 15d-15(e)) are designed only to provide reasonable assurance that they will meet their objectives. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial and accounting officer), of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e)) pursuant to Securities Exchange Act Rule 13a-15(b). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to provide the reasonable assurance discussed above.

Changes in Internal Control Over Financial Reporting

No changes in internal control over financial reporting occurred during the most recent fiscal quarter ended June 30, 2019 with respect to our operations, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As discussed in Note 2 to our consolidated financial statements in this report, we adopted ASU 2016-02 effective January 1, 2019. We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new standard on our financial statements. There were no significant changes to our internal control over financial reporting due to the adoption of ASU 2016-02.

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described in Part I, Item 1A, "Risk factors" in our Annual Report on Form 10-K for the year ended December 31, 2018, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our stock. There have been no material changes to our risk factors since our Annual Report on Form 10-K for the year ended December 31, 2018.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

The following table provides information about shares of common stock acquired or repurchased during the three months ended June 30, 2019. All of these acquisitions were of common stock withheld by us to satisfy 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.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs(1)	Approximate dollar value of shares that may yet be purchased under the plans or programs (in thousands)
Beginning balance, April 1, 2019				$ 50,000
April 1, 2019 through April 30, 2019	517	$ 82.52	—	50,000
May 1, 2019 through May 31, 2019	8,035	78.21	—	50,000
June 1, 2019 through June 30, 2019	8,567	80.21	—	50,000
Total	17,119	$ 79.34	—	$ 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.

ITEM 6. EXHIBITS

The exhibits listed below are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q:

Exhibit Number	Description of Document	Filed Herewith	Filed In		
			Form	Exhibit Number	Filing Date
3.1	Amended and Restated Bylaws of Blackbaud, Inc. dated June 13, 2019		8-K	3.1	6/14/2019
10.1	Amended and Restated Blackbaud, Inc. 2016 Equity and Incentive Compensation Plan		DEF 14A	Appendix B	4/24/2019
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
101.INS*	Inline XBRL Instance Document - the Instance Document does not appear in the interactive data file because its XBRL tags are embedded within the Inline XBRL Document.	X			
101.SCH*	Inline XBRL Taxonomy Extension Schema Document.	X			
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document.	X			
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document.	X			
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document.	X			
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document.	X			

** Pursuant to Rule 406T of Regulation S-T, the Inline XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended or otherwise subject to liability of that Section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, as amended, except as shall be expressly set forth by specific reference in such filing.*

SIGNATURES

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

			BLACKBAUD, INC.
Date:	August 2, 2019	By:	/s/ Michael P. Gianoni
			Michael P. Gianoni President and Chief Executive Officer (Principal Executive Officer)
Date:	August 2, 2019	By:	/s/ Anthony W. Boor
			Anthony W. Boor Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT 31.1

Blackbaud, Inc.

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

I, Michael P. Gianoni, certify that:

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

Date:	August 2, 2019	By:	/s/ Michael P. Gianoni
			Michael P. Gianoni
			President and Chief Executive Officer
			(Principal Executive Officer)

EXHIBIT 31.2

Blackbaud, Inc.

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

I, Anthony W. Boor, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Blackbaud, Inc.;

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

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

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

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

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

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

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

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

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

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

Date:	August 2, 2019	By:	/s/ Anthony W. Boor
			Anthony W. Boor
			Executive Vice President and Chief Financial Officer
			(Principal Financial and Accounting Officer)

EXHIBIT 32.1

Blackbaud, Inc.

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

In connection with the Quarterly Report on Form 10-Q of Blackbaud, Inc. (the "Company") for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), I, Michael P. Gianoni, President and Chief Executive Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date:	August 2, 2019	By:	/s/ Michael P. Gianoni
			Michael P. Gianoni
			President and Chief Executive Officer
			(Principal Executive Officer)

Blackbaud, Inc.

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

In connection with the Quarterly Report on Form 10-Q of Blackbaud, Inc. (the “Company”) for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on or about the date hereof (the “Report”), I, Anthony W. Boor, Executive Vice President and Chief Financial Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date:	August 2, 2019	By:	/s/ Anthony W. Boor
			Anthony W. Boor
			Executive Vice President and Chief Financial Officer
			(Principal Financial and Accounting Officer)