CASTLIGHT HEALTH, INC.
Form 10-Q
August 08, 2016
Table of Contents

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

FORM 10-Q

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from______ to ______

Commission File Number: 001-36330
CASTLIGHT HEALTH, INC.
(Exact name of registrant as specified in its charter)

Delaware	26-1989091
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

150 Spear Street, Suite 400
San Francisco, CA 94105
(Address of principal executive offices)

(415) 829-1400
(Registrant’s telephone number, including area code)

Two Rincon Center
121 Spear Street, Suite 300
San Francisco, CA 94105
(Former name or former address, if changed since last report)

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 [x] No []

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

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

Large accelerated filer [ ]	Accelerated filer [X]	Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

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

As of August 4, 2016, there were 54,398,980 shares of the Registrant’s Class A common stock outstanding and 48,300,276 shares of the Registrant’s Class B common stock outstanding.

Table of Contents

TABLE OF CONTENTS

	Page
PART I. Financial Information	1
Item 1. Financial Statements	1
Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015	1
Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2016 and 2015	2
Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2016 and 2015	3
Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2016 and 2015	4
Notes to Condensed Consolidated Financial Statements	5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3. Quantitative and Qualitative Disclosures About Market Risk	21
Item 4. Controls and Procedures	21
PART II. Other Information	21
Item 1. Legal Proceedings	21
Item 1A. Risk Factors	22
Item 2. Unregistered Sale of Equity Securities and Use of Proceeds	42
Item 3. Defaults Upon Senior Securities	42
Item 4. Mine Safety Disclosures	42
Item 5. Other Information	42
Item 6. Exhibits	44
Signature	45
Exhibit Index	46

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

CASTLIGHT HEALTH, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	As of June 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$40,651	$ 19,150
Marketable securities	85,042	101,274
Accounts receivable, net	12,491	12,751
Deferred commissions	6,072	5,438
Prepaid expenses and other current assets	5,140	3,772
Total current assets	149,396	142,385
Property and equipment, net	6,476	6,896
Marketable securities, noncurrent	—	13,335
Restricted cash, noncurrent	1,000	1,000
Deferred commissions, noncurrent	5,098	4,923
Other assets	4,692	4,735
Total assets	$166,662	$ 173,274
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$3,197	$ 3,384
Accrued expenses and other current liabilities	7,892	4,550
Accrued compensation	7,969	11,477
Deferred revenue	29,200	26,590
Total current liabilities	48,258	46,001
Deferred revenue, noncurrent	6,497	7,522
Other liabilities, noncurrent	1,689	1,397
Total liabilities	56,444	54,920
Commitments and contingencies		
Stockholders’ equity:		
Class A and Class B common stock	10	10
Additional paid-in capital	445,297	415,519
Accumulated other comprehensive income (loss)	54	(79)
Accumulated deficit	(335,143)	(297,096)
Total stockholders’ equity	110,218	118,354
Total liabilities and stockholders’ equity	$166,662	$ 173,274

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

CASTLIGHT HEALTH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue:				
Subscription	$21,955	$17,278	$42,992	$32,184
Professional services	1,630	1,232	3,310	2,277
Total revenue	23,585	18,510	46,302	34,461
Cost of revenue:				
Cost of subscription (1)	4,094	2,932	8,230	5,451
Cost of professional services (1)	4,850	5,322	9,963	9,975
Total cost of revenue	8,944	8,254	18,193	15,426
Gross profit	14,641	10,256	28,109	19,035
Operating expenses:				
Sales and marketing (1)	15,452	17,641	31,734	34,104
Research and development (1)	9,961	7,391	20,046	13,985
General and administrative (1)	6,019	6,517	14,564	11,980
Total operating expenses	31,432	31,549	66,344	60,069
Operating loss	(16,791)	(21,293)	(38,235)	(41,034)
Other income, net	99	81	188	179
Net loss	$(16,692)	$(21,212)	$(38,047)	$(40,855)
Net loss per Class A and B share, basic and diluted	$(0.17)	$(0.23)	$(0.39)	$(0.44)
Weighted-average shares used to compute basic and diluted net loss per Class A and B share	99,728	93,804	98,009	92,801

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Cost of revenue:				
Cost of subscription	$120	$ 67	$228	$100
Cost of professional services	535	450	1,012	875
Sales and marketing	2,219	2,074	4,454	3,825
Research and development	1,264	730	2,669	1,363
General and administrative	971	896	2,240	1,923

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

CASTLIGHT HEALTH, INC
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	$(16,692)	$(21,212)	$(38,047)	$(40,855)
Other comprehensive income:				
Net change in unrealized gain on available-for-sale marketable securities	30	8	133	50
Reclassification adjustments for net realized gains on available-for-sale marketable securities	—	—	—	—
Other comprehensive income	30	8	133	50
Comprehensive loss	$(16,662)	$(21,204)	$(37,914)	$(40,805)

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

CASTLIGHT HEALTH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Six Months Ended June 30,	
	2016	2015
Operating activities:		
Net loss	$(38,047)	$(40,855)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,585	910
Stock-based compensation	10,603	8,086
Amortization of deferred commissions	2,115	1,659
Accretion and amortization of marketable securities	305	827
Changes in operating assets and liabilities:		
Accounts receivable	260	49
Deferred commissions	(2,924)	(1,751)
Prepaid expenses and other assets	(813)	(1,818)
Accounts payable	(110)	1,258
Accrued expenses and other liabilities	(463)	(3,169)
Deferred revenue	1,585	4,403
Net cash used in operating activities	(25,904)	(30,401)
Investing activities:		
Restricted cash	—	(1,000)
Investment in related party	—	(3,125)
Purchase of property and equipment	(1,242)	(1,693)
Purchase of marketable securities	(61,192)	(18,958)
Sales of marketable securities	—	5,000
Maturities of marketable securities	90,587	61,553
Net cash provided by investing activities	28,153	41,777
Financing activities:		
Proceeds from the exercise of stock options	1,940	2,826
Proceeds from issuance of common stock and warrants	17,358	—
Payments of issuance costs	(46)	(94)
Net cash provided by financing activities	19,252	2,732
Net increase in cash and cash equivalents	21,501	14,108
Cash and cash equivalents at beginning of period	19,150	17,425
Cash and cash equivalents at end of period	$40,651	$31,533

See Notes to Condensed Consolidated Financial Statements.

Table of Contents
CASTLIGHT HEALTH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1. Organization and Description of Business
Description of Business
Castlight Health Inc. (the "Company") offers a health benefits platform that engages employees to make better health care decisions and enables employers to communicate and measure their benefit programs. The Company provides a simple, personalized, and powerful way for employees to shop for and manage their health care. At the same time, the Company enables employers to understand their employees’ needs and guide them to the right care, right providers and right programs at the right time. The Company's comprehensive technology offering aggregates complex, large-scale data and applies sophisticated analytics to make health care data transparent and useful. The Company was incorporated in the State of Delaware in January 2008. The Company's principal executive offices are located in San Francisco, California.

Note 2. Summary of Significant Accounting Policies
Basis of Presentation and Principles of Consolidation
The accompanying unaudited condensed consolidated financial statements were prepared in accordance with U.S. generally accepted accounting principles (GAAP), for interim financial information and with the instructions to Form 10-Q and Article 10 of Securities and Exchange Commission (SEC), Regulation S-X. In the opinion of management, the information herein reflects all adjustments, consisting only of normal recurring adjustments except as otherwise noted, considered necessary for a fair statement of results of operations, financial position and cash flows. The condensed consolidated financial statements include the results of Castlight and its wholly owned U.S. subsidiary. The results for the interim periods presented are not necessarily indicative of the results expected for any future period. The condensed consolidated balance sheet as of December 31, 2015 included herein was derived from the audited financial statements as of that date. The following information should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. There have been no changes to the Company's significant accounting policies described in the Company's Annual Report on Form 10-K that have had a material impact on its condensed consolidated financial statements and related notes.
Use of Estimates
The preparation of condensed consolidated financial statements in conformity with GAAP requires the Company to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. These estimates include, but are not limited to, the determination of the relative selling prices for the Company's products and services, certain assumptions used in the valuation of the Company's equity awards, annual bonus attainment and the capitalization and estimated useful life of internal-use software development costs. Actual results could differ from those estimates, and such differences could be material to the Company's consolidated financial position and results of operations.
Recently Issued and Adopted Accounting Pronouncements

Credit Losses

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update (“ASU”) 2016-13, “Measurement of Credit Losses on Financial Instruments.” The guidance changes the impairment model for most financial assets and certain other instruments. For trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward-looking expected loss model that generally will result in the earlier recognition of allowances for losses. For available-for-sale debt securities with unrealized

losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. This guidance will be effective for the Company beginning January 1, 2020 and earlier adoption is permitted beginning 2019. The Company is evaluating the accounting, transition and disclosure requirements of the

Table of Contents

standard and cannot currently estimate the financial statement impact of adoption. At this point in time, the Company does not intend to adopt the standard early.

Stock-based Compensation

In March 2016, the FASB issued ASU 2016-09, “Compensation-Stock Compensation: Improvements to Employee Share-Based Payment.” The guidance will change how companies account for certain aspects of share-based payments to employees. The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. The standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted in any interim or annual period. Accordingly, the standard is effective for the Company beginning January 1, 2017, and the Company is currently evaluating the impact that the standard will have on the Company's consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases." The guidance will require lessees to put all leases on their balance sheets, whether operating or financing, while continuing to recognize the expenses on their income statements in a manner similar to current practice. The guidance states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The guidance will be effective for the Company beginning January 1, 2019. The Company is evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption. At this point in time, the Company does not intend to adopt the standard early.

Financial Instruments

In January 2016, the FASB issued ASU 2016-1, “Financial Instruments.” The guidance provides a new measurement alternative for equity investments that don’t have readily determinable fair values and don’t qualify for the net asset value practical expedient. Under this alternative, these investments can be measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment if the same issuer. This guidance will be effective for the Company beginning January 1, 2018 and earlier adoption is not permitted. The Company is evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption at this point in time.

Cloud Computing Arrangements

In April 2015, the FASB issued ASU 2015-05, “Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." The guidance is intended to help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement, primarily to determine whether the arrangement includes a sale or license of software. The Company adopted this guidance on January 1, 2016 and it does not impact the Company's financial statements.

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers.” The guidance provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB deferred the effective date of the standard for all entities by one year. The standard will become effective for the annual

reporting period (including interim reporting periods) beginning after December 15, 2017, and early adoption is permitted as of annual reporting periods (including interim periods) beginning after December 15, 2016. The Company is evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption. At this point in time, the Company does not intend to adopt the standard early.

Note 3. Marketable Securities

Table of Contents

CASTLIGHT HEALTH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(unaudited)

All of the Company's cash equivalents and marketable securities are classified as “available-for-sale” securities. These securities are reported at fair value, with the related unrealized gains and losses included in accumulated other comprehensive income, a component of shareholders’ equity.

At June 30, 2016 and December 31, 2015, respectively, marketable securities consisted of the following (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2016				
U.S. agency obligations	$ 52,670	$ 30	$ (1)	$52,699
U.S. treasury securities	32,318	26	(1)	32,343
Money market mutual funds	23,560	—	—	23,560
	108,548	56	(2)	108,602
Included in cash and cash equivalents	23,560	—	—	23,560
Included in marketable securities	$ 84,988	$ 56	$ (2)	$85,042

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2015				
U.S. agency obligations	$83,763	$ —	$ (48)	$83,715
U.S. treasury securities	33,924	—	(31)	33,893
Money market mutual funds	1,038	—	—	1,038
	118,725	—	(79)	118,646
Included in cash and cash equivalents	4,038	—	(1)	4,037
Included in marketable securities	$101,334	$ —	$ (60)	$101,274
Included in marketable securities, noncurrent	$13,353	$ —	$ (18)	$13,335

Note 4. Fair Value Measurements

The Company measures its financial assets and liabilities at fair value at each reporting period using a fair value hierarchy that requires that the Company maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument’s classification within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs may be used to measure fair value:

Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2—Include other inputs that are directly or indirectly observable in the marketplace.

Level 3—Unobservable inputs that are supported by little or no market activity.

The fair value of marketable securities included in the Level 2 category is based on observable inputs, such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. These values were obtained from a third-party pricing service and were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well-established third party pricing vendors and broker-dealers. There have been no changes in valuation techniques in the periods presented. The Company has no financial assets or liabilities measured using Level 3 inputs. There were no significant transfers between Levels 1 and 2 assets as of June 30, 2016 and December 31, 2015. The following tables present information about the Company's assets that are measured at fair value on a recurring basis using the above input categories (in thousands):

Table of Contents
CASTLIGHT HEALTH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(unaudited)

	Level 1	Level 2	Total
June 30, 2016			
Cash equivalents:			
Money market mutual funds	$23,560	$—	$23,560
Marketable securities:			
U.S. agency obligations	—	52,699	52,699
U.S. treasury securities	—	32,343	32,343
	$23,560	$85,042	$108,602

	Level 1	Level 2	Total
December 31, 2015			
Cash equivalents:			
Money market mutual funds	$1,038	$—	$1,038
U.S. agency obligations	—	3,000	3,000
Marketable securities:			
U.S. agency obligations	—	80,715	80,715
U.S. treasury securities	—	33,893	33,893
	$1,038	$117,608	$118,646

Gross unrealized gains and losses for cash equivalents and marketable securities as of June 30, 2016 and December 31, 2015 were not material. The Company does not believe the unrealized losses represent other-than-temporary impairments based on the Company's evaluation of available evidence as of June 30, 2016 and December 31, 2015.
There were no realized gains or losses during the six months ended June 30, 2016. All of the Company's marketable securities at June 30, 2016 mature within one year. As of December 31, 2015, those securities with maturities greater than one year are reflected in the noncurrent portion of the Company's condensed consolidated balance sheets. Marketable securities on the balance sheets consist of securities with original or remaining maturities at the time of purchase of greater than three months, and the remainder of the securities is reflected in cash and cash equivalents.
Note 5. Property and Equipment
Property and equipment consisted of the following (in thousands):

	As of June 30, 2016	December 31, 2015
Leasehold improvements	$2,145	$ 2,046
Computer equipment	5,110	4,345
Software	1,136	885
Capitalization of internal-use software	2,925	2,925
Furniture and equipment	853	853
Total	12,169	11,054
Accumulated depreciation	(5,693)	(4,158)
Property and equipment, net	$6,476	$ 6,896

Depreciation and amortization expense for the three months ended June 30, 2016 and 2015, was $0.8 million and $0.5 million, respectively. Depreciation and amortization expense for the six months ended June 30, 2016 and 2015, was $1.6 million and $0.9 million, respectively. Depreciation and amortization are recorded on a straight-line basis.
Note 6. Related Party Transactions and Variable Interest Entity

In the second quarter of 2015, the Company announced a strategic alliance with Lyra Health ("Lyra"), to develop and bring to market an integrated behavioral health solution. In connection with this strategic alliance, the Company made an initial preferred stock investment in Lyra of $3.1 million and its chief executive officer, Dr. Colella, joined the Lyra board. Additionally, the Company made a subsequent preferred stock investment in Lyra of $1.0 million in August 2015. In March of 2016, the Company amended the strategic alliance to modify the manner in which the Company collaborates with Lyra on the solution. In connection with this amendment, Dr. Colella ceased service on the Lyra board of directors. Lyra is considered a related party to the Company because two of the Company's directors, Dr. Roberts and Mr. Ebersman, serve on the Lyra board of directors and Mr. Ebersman is the Lyra chief executive officer. An independent committee of the Company's board of directors, comprised of directors without any involvement in any external behavioral health business initiatives, approved the strategic alliance with and investment in Lyra.

The Company has evaluated all its transactions with Lyra and has determined that Lyra is a variable interest entity (“VIE”) for the Company. In determining that the Company is not the VIE's primary beneficiary, the Company considered qualitative and quantitative factors, including, but not limited to: which activities most significantly impact the VIE’s economic performance and which party controls such activities; the characteristics of the Company's involvement; and the obligation or likelihood for the Company to provide incremental financial support. Based on the Company's evaluation, the Company determined it is not required to consolidate the operations of the VIE. The Company's maximum exposure to loss as a result of its involvement with this unconsolidated VIE is limited to its investment of $4.1 million and it is not obligated to provide incremental financial support to Lyra.

The investment in Lyra is accounted for under the cost method and is included under other assets in the Company's consolidated financial statements. The Company has not estimated the fair value of its investment because there have been no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. The Company assesses its investment for impairment on a quarterly basis or based on facts or circumstances that may require it to reassess the fair value of its investment. Based on the facts and circumstances as of June 30, 2016, the Company concluded that its investment was appropriately valued.

Note 7. Deferred Revenue

Deferred revenue consisted of the following (in thousands):

	As of	
	June 30, 2016	December 31, 2015
Subscription	$20,787	$ 18,029
Professional services—implementation	5,109	5,254
Professional services—communications	3,304	3,307
Total current	29,200	26,590
Subscription	334	1,163
Professional services—implementation	4,939	5,367
Professional services—communications	1,224	992
Total noncurrent	6,497	7,522
Total	$35,697	$ 34,112

Note 8. Commitments and Contingencies

Legal Matters

On April 2, April 16, April 29, and May 4, 2015, purported securities class action lawsuits were filed in the Superior Court of the State of California, County of San Mateo, against the Company, certain of its current and former

directors, executive officers, significant stockholders and underwriters associated with its initial public offering (IPO). The lawsuits, which were consolidated on July 22, 2015, were brought by purported stockholders of the Company seeking to represent a class consisting of all those who purchased the Company's stock pursuant or traceable to the Registration Statement and Prospectus issued in connection with its IPO. A consolidated complaint (“Complaint”) was filed on July 23, 2015, alleging claims under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933. On September 22, 2015 the Company filed a demurrer to the Complaint. After briefing and argument, the Court overruled the demurrer as to Plaintiffs’ claims under Sections 11 and 15 and

9

granted with leave to amend, the demurrer to Plaintiff's claims under Section 12(a)(2). Plaintiffs filed an amended consolidated complaint ("Amended Complaint") on November 10, 2015. On December 10, 2015, the Company filed a demurrer to the Section 12(a)(2) claim in the Amended Complaint. On January 28, 2016, the Court again sustained the demurrer to the Section 12(a)(2) claim in the amended Complaint. The Amended Complaint sought unspecified damages and other relief. On March 28, 2016, the parties to the consolidated actions reached a mutually acceptable resolution by way of a mediated cash settlement. The aggregate amount of the settlement under the agreement in principle is $9.5 million. The Court granted preliminary approval of the settlement on July 13, 2016 and has set a final approval hearing for October 28, 2016, and therefore the settlement is subject to final documentation and court approval. As a result of the settlement the Company recorded a net charge of $2.9 million to general and administrative expense in 2016. This amount represents the portion of settlement that was not covered by insurance and legal fees incurred in 2016 regarding this matter. Funds representing the Company's portion of the settlement amount were moved to escrow in the third quarter of 2016 and the Company expects them to be paid in the fourth quarter of 2016. While the Company believes it has meritorious defenses to the litigation, the Company is satisfied with this resolution given the risks and expenses associated with further litigation. The Company accrues for loss contingencies when it is both probable that it will incur the loss and when it can reasonably estimate the amount of the loss or range of loss.

From time to time, the Company may become subject to other legal proceedings, claims or litigation arising in the ordinary course of business. In addition, the Company may receive letters alleging infringement of patents or other intellectual property rights. If an unfavorable outcome were to occur in litigation, the impact could be material to the Company's business, financial condition, cash flow or results of operations, depending on the specific circumstances of the outcome.

Leases and Contractual Obligations

The Company's principal commitments primarily consist of obligations under leases for office space and co-location facilities for data center capacity. The Company's existing lease agreements provide it with the option to renew and generally provide for rental payments on a graduated basis. The Company's future operating lease obligations would change if it entered into additional operating lease agreements as the Company expands its operations and if it exercised these options.

There were no other material changes in the Company's contractual obligations from those disclosed in its Annual Report on Form 10-K for the year ended December 31, 2015. Please see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in the Company's Annual Report on Form 10-K for a description of its contractual obligations.

Note 9. Stock Compensation

Stock Options Activity

A summary of stock option activity for the six months ended June 30, 2016 is as follows (in thousands, except share and per share amounts):

	Options Outstanding	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Balance at December 31, 2015	9,561,713	$ 5.62	$ 16,694
Stock option grants	3,223,396	$ 2.99	
Stock options exercised	(1,422,730)	$ 1.36	

Stock options canceled	(3,347,321)	$ 9.94	
Balance at June 30, 2016	8,015,058	$ 3.52	$ 13,749

The total grant-date fair value of stock options granted during the six months ended June 30, 2016 and 2015 was $2.5 million and $2.3 million, respectively.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-valuation model with the following assumptions and fair value per share:

Table of Contents

	Six Months Ended June 30,	
	2016	2015
Volatility	45%	53%
Expected life (in years)	6.02	6.17
Risk-free interest rate	1.37%	1.38%-1.91%
Dividend yield	—%	—%

As of June 30, 2016, the Company had $14.9 million in unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a weighted-average period of approximately 2.3 years.

The options granted and canceled in the six months ended June 30, 2016 in the table above include options that were exchanged under the Company’s stock option exchange program. Pursuant to the stock option exchange program, 108 out of 132 eligible employees tendered options covering an aggregate of 2,685,396 shares of the Company's Class A and Class B common stock at a weighted average exercise price of $11.03, in exchange for options to purchase 2,685,396 shares of its Class B common stock at an exercise price of $2.99 per share, the closing sale price reported on the New York Stock Exchange on February 24, 2016. Each new grant began a new vesting period commencing on the date of grant over five years in equal monthly installments. As of February 15, 2016 the incremental expense related to this offer was $1.8 million, which will be recognized over five years.

For more information, refer to the Company's Tender Offer Statement filed with the Securities and Exchange Commission on January 12, 2016, as amended on January 28, 2016 and February 26, 2016.

Restricted Stock Units

A summary of restricted stock unit activity for the six months ended June 30, 2016 is as follows:

	Number of Shares Outstanding	Weighted-Average Grant Date Fair Value
Balance at December 31, 2015	6,685,118	$ 7.63
Restricted Stock Units granted (1)	4,187,075	$ 3.15
Restricted Stock Units vested	(858,150)	$ 9.03
Restricted Stock Units forfeited/canceled (2)	(1,290,419)	$ 7.28
Balance at June 30, 2016	8,723,624	$ 5.40

(1) Includes PSUs that were granted in February 2016.
(2) Includes PSUs that were granted in the prior year, which were canceled because performance targets were not achieved.

As of June 30, 2016, there was a total of $40.0 million in unrecognized compensation cost related to restricted stock units, which is expected to be recognized over a weighted-average period of approximately 3.0 years.

In February 2016, the Company awarded performance stock units (PSUs) to certain employees. The number of shares that will eventually vest depends on achievement of performance targets for 2016, as determined by the compensation committee of the Company's board of directors, and may range from 0 to 150% of the targeted award amount. Once the performance is determined and a targeted award amount is fixed, the target number of PSUs, if any, will vest in eight quarterly installments, subject to recipients' continued service, beginning on February 16, 2017. The compensation expense associated with the PSUs is recognized using the accelerated method. No expense has been

recorded through June 30, 2016 as the Company determined the achievement of the performance targets was not probable.

Note 10. Stockholders' Equity

Common Stock

As of June 30, 2016, the Company had 54,398,980 shares of Class A common stock and 48,262,650 shares of Class B common stock outstanding.

Transactions with SAP Technologies, Inc.

In May 2016, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") with SAP Technologies, Inc. ("SAP") pursuant to which it sold and issued to SAP 4.7 million shares ("Shares") of its Class B Common Stock and a warrant ("Warrant") to purchase up to 1.9 million shares of its Class B Common Stock. The net proceeds from this transaction were $17.8 million and will be used for working capital and other general corporate purposes.

The exercise price of the Warrant is $4.91 per share and will expire four years from the date the Company enters into agreements with SAP related to both SAP's Connected Health platform and also related to SAP's distribution of the Company's solutions (the "Alliance Agreements"). The Alliance Agreements will be focused on a strategic, multi-pronged business relationship aimed at delivering integrated healthcare technologies that can help lower healthcare costs, improve outcomes and increase benefits satisfaction for customers. If the Company does not enter into the Alliance Agreements with SAP by May 17, 2017, then the Warrant will become void.

The Shares and Warrant are considered freestanding instruments from each other and are classified within stockholders' equity. The Company preliminarily allocated the net proceeds to the Shares and Warrant and also to a customer prepayment liability classified within accrued expenses and other current liabilities that represents the future benefits of the Alliance Agreements. Additional accounting for the Warrants and the customer prepayment liability is dependent on if and when the Alliance Agreements are executed.

Note 11. Income Taxes

The effective tax rate for the three and six months ended June 30, 2016 and 2015 was zero percent, primarily as a result of the estimated tax loss for the year and the change in valuation allowance. At June 30, 2016, all unrecognized tax benefits are subject to a full valuation allowance and, if recognized, will not affect the effective tax rate.

Note 12. Net Loss per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including Preferred Stock and outstanding stock options and warrants, to the extent dilutive. Basic and diluted net loss per share was the same for each period presented as the inclusion of all potential shares of common stock outstanding would have been anti-dilutive.

Net loss is allocated based on the contractual participation rights of the Class A and Class B common stock as if the earnings for the year have been distributed. As the liquidation and dividend rights are identical, the net loss is allocated on a proportionate basis.

The following table presents the calculation of basic and diluted net loss per share for the Company's common stock (in thousands, except per share data):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Net loss	$(9,120)	$(7,572)	$(13,086)	$(8,126)	$(21,158)	$(16,889)	$(25,658)	$(15,197)
Weighted-average shares used to compute basic and diluted net loss per share	54,489	45,239	57,870	35,934	54,503	43,506	58,282	34,519
Basic and diluted net loss per share	$(0.17)	$(0.17)	$(0.23)	$(0.23)	$(0.39)	$(0.39)	$(0.44)	$(0.44)

The following securities were excluded from the calculation of diluted net loss per share for common stock because their effect would have been anti-dilutive for the periods presented (in thousands):

CASTLIGHT HEALTH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Stock options and restricted stock units	19,114	16,410	19,114	16,410
Warrants*	2,020	115	2,020	115
Total	21,134	16,525	21,134	16,525

*includes 1.9 million warrants issued to SAP that are exercisable upon execution of the Alliance Agreements.

Table of Contents
CASTLIGHT HEALTH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(unaudited)

Note 13. Reduction in Workforce

On May 10, 2016, the Company’s Board of Directors committed to a program to reduce the Company's workforce in order to reduce expenses, align its operations with evolving business needs and improve efficiencies. Under this program, the Company undertook a program to reduce its workforce by approximately fourteen percent. Accordingly the Company expects to incur charges of $0.8 million in 2016. For the three and six months ended June 30, 2016, the Company recorded a $0.7 million charge, all of which was related to severance costs. As of June 30, 2016, $0.2 million of the total has been paid out and the remaining balance of $0.6 million is expected to be to be fully paid by December 31, 2016.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to the “safe harbor” created by those sections. Forward-looking statements are based on our management’s beliefs and assumptions and on information currently available to our management. In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “could,” “goal,” “would,” “expect,” “plan,” “anticipate,” "intend,"“estimate,” “project,” “predict,” “potential” and similar expressions intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance, time frames or achievements to be materially different from any future results, performance, time frames or achievements expressed or implied by the forward-looking statements. We discuss many of these risks, uncertainties and other factors in this Quarterly Report on Form 10-Q in greater detail under the section titled “Risk Factors” set forth in Part II, Item 1A in this Quarterly Report on Form 10-Q. Given these risks, uncertainties and other factors, you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this filing. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect. We hereby qualify our forward-looking statements by these cautionary statements. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

All references to "Castlight," “Castlight Health,” “we,” “us,” “our” or the “Company” mean Castlight Health, Inc. and its subsidiaries, except where it is made clear that the term means only the parent company.

Castlight Health, Castlight, Castlight Medical, Castlight Essentials, Castlight Pharmacy, Castlight Rewards, Castlight Reference-Based Pricing, Castlight Protect, Castlight Insights, Castlight Controls, Castlight Connect, Castlight Care, Castlight Dental, Castlight Elevate and Castlight Action are trademarks and/or registered trademarks of Castlight Health, Inc. in the United States and other countries. Other company and product names may be trademarks of the respective companies with which they are associated.

Overview

Castlight offers a health benefits platform that engages employees to make better health care decisions and enables employers to communicate and measure their benefit programs. We provide a simple, personalized, and powerful way for employees to shop for and manage their health care. At the same time, we enable employers to understand their employees' needs and guide them to the right care, right providers and right programs at the right time. Our comprehensive technology offering aggregates complex, large-scale data and applies sophisticated analytics to make health care data transparent and useful. Our products are designed to deliver strong employee engagement and can be used to enable employers to integrate disparate benefit programs into a single platform available to employees and their families. Ultimately, we help enable organizations and their employees to improve outcomes, lower health care costs, and increase benefits satisfaction.

Since our inception in 2008, we have been committed to improving the efficiency of the U.S. health care industry. From 2008 to 2010, we focused our efforts on research and development to build our consumer health care database, our analytic capabilities and the initial version of our cloud-based product which constitutes our core Castlight platform. After its

release in 2010, we have continued to enhance that product, as well as release new products, including Castlight Pharmacy, Castlight Dental, Castlight Action, Castlight Elevate, Castlight Protect, and Castlight Rewards. These products are delivered to our customers, and their employees and families, via our cloud-based offering and leverage consumer-oriented design principles that drive engagement and ease of use.

We market and sell our health benefits platform to self-insured companies in a broad range of industries and to governmental entities. We sell our offering solely in the United States, and we market to our customers and potential customers through our direct sales force, as well as through relationships with health plans, benefits consultants and other channel partners.

We intend to continue to invest aggressively in the success of our customers, expand our commercial operations and further develop our offering. As a result of these and other factors, we expect to continue to incur operating losses for the foreseeable future and may need to raise additional capital through equity and debt financings in order to fund our operations.

Key Factors Affecting Our Performance

Sales of New and Additional Products. Our revenue growth rate and long-term profitability are affected by our ability to sell new and additional products to our customer base. To date, a substantial majority of our revenue has come from sales of subscriptions to our core Castlight platform. We believe that there is a significant opportunity to sell subscriptions to other products as our customers become more familiar with our offering and seek to address additional needs.

Renewals of Customer Contracts. We believe that our ability to retain our customers and expand their subscription revenue growth over time will be an indicator of the stability of our revenue base and the long-term value of our customer relationships.

Implementation Timelines. Our ability to convert backlog into revenue and improve our gross margin depends on how quickly we complete customer implementations. Our implementation timelines vary from customer to customer based on the source and condition of the data we receive from third parties, the configurations that we agree to provide and the size of the customer. Our implementation timelines for our core Castlight platform are typically three to nine months after entering into an agreement with a customer. Our implementation timelines for our other products currently range from approximately three to twelve months.

Professional Services Model. We believe our professional services capabilities support the adoption of our subscription offerings. As a result, our sales efforts have been focused primarily on our subscription offering, rather than the profitability of our professional services business. Our professional services are generally priced on a fixed-fee basis and the costs incurred to complete these services, which consist mainly of personnel-related costs, have been greater than the amount charged to the customer. We also do not have standalone value for our implementation services for accounting purposes. Accordingly, we recognize implementation services revenue in the same manner as the associated subscription revenue. Prior to launching an individual customer, we incur significant costs associated with implementation activities, which we record as cost of revenue. Since we do not recognize significant revenues from an individual customer until we launch, we generate a negative gross margin at the customer level during the implementation period.

Seasonality. A significantly higher proportion of our customers enter into new subscription agreements with us in the third and fourth quarters of the year, compared to the first and second quarters. The impact from this seasonality is not immediately apparent in our revenue because we do not begin recognizing revenue from new customer agreements until we have implemented our offering, based on the implementation timelines discussed above.

Revenue recognized in any quarter is primarily from customer agreements entered into in prior quarters. In addition, the mix of customers paying monthly, quarterly, or annually varies from quarter to quarter and impacts our deferred revenue balance. As a result of variability in our billing and implementation timelines, the deferred revenue balance does not represent the total value of our customer contracts, nor do changes in deferred revenue serve as a reliable indicator of our future subscription revenue.

Key Business Metrics

We review a number of operating metrics, including the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, and make strategic decisions.

Table of Contents

Signed Annual Recurring Revenue

	As of June 30,	
	2016	2015
	(in millions)	
Signed Annual Recurring Revenue (ARR)	$117.8	$93.4

Our ability to recognize and increase subscription revenue in the future depends in part upon our ability to add new customers, retain and renew existing customers and expand the number of offerings to which our new and existing customers subscribe over time. As discussed above, we begin recognizing revenue from new customer agreements when we have implemented our offering, which can take from approximately three to twelve months. Therefore, revenue recognized in any quarter is largely derived from customer agreements signed in prior quarters. Accordingly, management measures sales performance and forecasts future subscription revenue based on signed Annual Recurring Revenue (ARR).

ARR represents the annualized value of subscription revenue under contract with customers at the end of a quarter, which we refer to for this purpose as a measurement date. To calculate ARR, we first calculate the annualized subscription value for each signed customer (whether implemented or not), as of the applicable measurement date, by multiplying the monthly contract value of the subscription services under contract by 12. We exclude from this calculation any customers that have provided us with formal notice of termination or non-renewal as of the measurement date. ARR does not take into account the (i) potential for customers to terminate, or decline to renew, their agreements with us, (ii) achievement of non-recurring or yet-to-be-earned performance guarantees, (iii) one-time engagement bonuses included within our customer contracts or (iv) revenues related to professional services, such as implementation and communications services. ARR is not determined in reference to US GAAP.

ARR is a forward-looking metric based on contractual terms in existence as of the applicable measurement date and is subject to change resulting from a number of factors including, but not limited to, changes in user counts, terminations or non-renewals, as well as upsells and cross-sells. For all of these reasons, the amount of subscription revenue we actually recognize during periods following the measurement date may be different from ARR recorded at a measurement date.

Our ARR at June 30, 2016 was $117.8 million, compared to $93.4 million at June 30, 2015, representing an increase of approximately 26%. We expect ARR to increase as we sign additional customers and cross-sell to existing customers.

Annual Net Dollar Retention Rate

	Twelve Months Ended December 31,	
	2015	2014
Annual Net Dollar Retention Rate (NDR)	116%	103%

Our revenue growth rate and long-term profitability are affected by our ability to add customers, retain and renew existing customers, and expand the number of offerings our new and existing customers use over time. We believe that our ability to retain our customers and expand their subscription revenue growth over time will be an indicator of the stability of our revenue base and the long-term value of our customer relationships. We assess our performance on

customer retention by measuring our Annual Net Dollar Retention rate (NDR). Our NDR provides a measurement of our ability to increase revenue across our existing customer base through expansion of our additional products to existing customers, increases in user count for existing customers and customer renewals, as offset by terminations. We observed an annual net dollar retention rate of 116% and 103% for our signed customer base, for the years ended December 31, 2015 and 2014, respectively. We calculate annual net dollar retention rate for a given period as the aggregate annualized subscription contract value as of the last day of that year from those customers that were also customers as of the last day of the prior year, divided by the aggregate annualized subscription contract value from all customers as of the last day of the prior year. In calculating NDR, we exclude one-time fees. NDR does not include subscriptions by new customers contracted since the end of the most recently completed year. We expect NDR to be more than 100% for the year ended December 31, 2016.

Components of Results of Operations

Revenue

We generate revenue from subscription fees from customers for access to the products they select, including basic customer service support. We also earn revenue from professional services primarily related to the implementation of our offering, including extensive communications support to drive adoption by our customers' employees and their dependents. Historically, we have derived a substantial majority of our subscription revenue from our core Castlight platform. Our subscription fees are based primarily on the number of employees and adult dependents that employers identify as eligible to use our offering, which typically includes all of our customers’ U.S. employees and adult dependents that receive health benefits.

We recognize subscription fees on a straight-line basis ratably over the contract term beginning when our products are implemented and ready for launch, which is based on the implementation timelines discussed above. Our customer agreements generally have a term of three years. We generally invoice our customers in advance on a monthly, quarterly or annual basis. Amounts that have been invoiced are initially recorded as deferred revenue. Amounts that have not been invoiced are not reflected in our condensed consolidated financial statements. We generally invoice our implementation services upon contract signing on a fixed-fee basis, which is generally when we commence work.

As a result of variability in our billing terms, the deferred revenue balance does not represent the total value of our customer contracts, nor do changes in deferred revenue serve as a reliable indicator of our future subscription revenue in a given period.

Costs of Revenue

Cost of revenue consists of the cost of subscription revenue and cost of professional services revenue.

Cost of subscription revenue primarily consists of data fees, employee-related expenses (including salaries, benefits and stock-based compensation) related to hosting costs of our cloud-based service, cost of subcontractors, expenses for service delivery (which includes call center support), allocated overhead, the costs of data center capacity, amortization of internal-use software and depreciation of owned computer equipment and software.

Cost of professional services revenue consists primarily of employee-related expenses (including salaries, benefits and stock-based compensation) associated with these services, the cost of subcontractors and travel costs and allocated overhead. The time and costs of our customer implementations vary based on the source and condition of the data we receive from third parties, the configurations that we agree to provide and the size of the customer.

Our cost of revenue is expensed as we incur the costs. However, the related revenue is deferred until our products are ready for use by the customer and then recognized as revenue ratably over the related contract term. Therefore, we expense the cost incurred to provide our products and services prior to the recognition of the corresponding revenue.

Operating Expenses

Operating expenses consist of sales and marketing, research and development and general and administrative expenses.

Sales and Marketing. Sales and marketing expenses consist primarily of employee-related expenses (including salaries, sales commissions and bonuses, benefits and stock-based compensation), travel-related expenses, marketing programs and allocated overhead. Commissions earned by our sales force and broker fees that can be associated specifically with the noncancelable portion of a subscription contract are deferred and amortized over the noncancelable period. Accordingly, commission expense can be materially impacted by changes in the termination provisions of customer contracts that we execute in a given period compared with previous periods.

Research and Development. Research and development expenses consist primarily of employee-related expenses (including salaries, bonuses, benefits and stock-based compensation), costs associated with subcontractors and allocated overhead.

Table of Contents

General and Administrative. General and administrative expenses consist primarily of employee-related expenses (including salaries and bonuses, benefits and stock-based compensation) for finance and accounting, legal, human resources and management information systems personnel, legal costs, professional fees, other corporate expenses and allocated overhead.

Overhead Allocation. Expenses associated with our facilities and IT costs are allocated between cost of revenues and operating expenses based on employee headcount determined by the nature of work performed.

Results of Operations

The following tables set forth selected consolidated statements of operations data and such data as a percentage of total revenue for each of the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(percentages of revenue)			
Revenue:				
Subscription	93 %	93 %	93 %	93 %
Professional services	7 %	7 %	7 %	7 %
Total revenue	100 %	100 %	100 %	100 %
Cost of revenue:				
Cost of subscription	17 %	16 %	18 %	16 %
Cost of professional services	21 %	29 %	21 %	29 %
Total cost of revenue	38 %	45 %	39 %	45 %
Gross margin percentage	62 %	55 %	61 %	55 %
Operating expenses:				
Sales and marketing	66 %	95 %	69 %	99 %
Research and development	42 %	40 %	43 %	40 %
General and administrative	26 %	35 %	31 %	35 %
Total operating expenses	134 %	170 %	143 %	174 %
Operating loss	(72)%	(115)%	(82)%	(119)%
Other income, net	— %	— %	— %	— %
Net loss	(72)%	(115)%	(82)%	(119)%

Revenue

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016	2015	% Change	$ Change	2016	2015	% Change	$ Change
	(dollars in thousands)				(dollars in thousands)			
Revenue:								
Subscription	$21,955	$17,278	27%	$ 4,677	$42,992	$32,184	34%	$ 10,808
Professional services	1,630	1,232	32%	398	3,310	2,277	45%	1,033
Total revenue	$23,585	$18,510	27%	$ 5,075	$46,302	$34,461	34%	$ 11,841

Total revenue for the three months ended June 30, 2016 increased $5.1 million or 27%, attributable to new customer launches that occurred in the trailing twelve months ended June 30, 2016 which contributed $3.1 million of the increase in total revenue year over year, and existing customer launches of cross-sell products which contributed $2.0 million of the increase. Our launched customer base grew more than 10% year over year.

Total revenue for the six months ended June 30, 2016 increased $11.8 million or 34%, attributable to new customer launches that occurred in the trailing twelve months ended June 30, 2016 which contributed $5.5 million of the increase in total revenue year over year, and existing customer launches of cross-sell products which contributed $6.3 million of the increase. Our launched customer base grew more than 10% year over year.

17

Table of Contents

Costs and Operating Expenses

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016	2015	% Change	$ Change	2016	2015	% Change	$ Change
	(dollars in thousands)				(dollars in thousands)			
Cost of revenue:								
Subscription	4,093	2,931	40 %	$ 1,162	8,230	5,451	51 %	$ 2,779
Professional services								