ServiceNow, Inc.
Form 10-Q
November 04, 2016
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# 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 September 30, 2016**
**OR**
¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**Commission File Number: 001-35580**

# SERVICENOW, INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **20-2056195** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification Number)** |

**ServiceNow, Inc.**
**2225 Lawson Lane**
**Santa Clara, California 95054**
**(408) 501-8550**
**(Registrant's telephone number, including area code)**

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

| | |
|---|---|
| Large accelerated filer x | Accelerated filer ¨ |
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | Smaller reporting company ¨ |

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

As of September 30, 2016, there were approximately 166.0 million shares of the Registrant’s Common Stock outstanding.

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**PART I**

**ITEM 1. FINANCIAL STATEMENTS**

**SERVICENOW, INC.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
*(in thousands)*

| | September 30, 2016 (Unaudited) | December 31, 2015 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $325,067 | $412,305 |
| Short-term investments | 481,813 | 388,945 |
| Accounts receivable, net | 220,089 | 203,333 |
| Current portion of deferred commissions | 62,657 | 51,976 |
| Prepaid expenses and other current assets | 37,281 | 29,076 |
| Total current assets | 1,126,907 | 1,085,635 |
| Deferred commissions, less current portion | 44,597 | 33,016 |
| Long-term investments | 281,353 | 422,667 |
| Property and equipment, net | 176,106 | 144,714 |
| Intangible assets, net | 60,726 | 43,005 |
| Goodwill | 84,425 | 55,669 |
| Other assets | 39,000 | 22,346 |
| Total assets | $1,813,114 | $1,807,052 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $30,012 | $37,369 |
| Accrued expenses and other current liabilities | 124,670 | 101,264 |
| Current portion of deferred revenue | 743,657 | 593,003 |
| Total current liabilities | 898,339 | 731,636 |
| Deferred revenue, less current portion | 18,048 | 10,751 |
| Convertible senior notes, net | 499,280 | 474,534 |
| Other long-term liabilities | 34,944 | 23,317 |
| Total liabilities | 1,450,611 | 1,240,238 |
| Stockholders' equity: | | |
| Common stock | 165 | 160 |
| Additional paid-in capital | 1,343,604 | 1,140,545 |
| Accumulated other comprehensive loss | (16,465) | (16,882) |
| Accumulated deficit | (964,801) | (557,009) |
| Total stockholders' equity | 362,503 | 566,814 |
| Total liabilities and stockholders' equity | $1,813,114 | $1,807,052 |

*See accompanying notes to condensed consolidated financial statements*

**SERVICENOW, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**
**(Unaudited)**
*(in thousands, except share and per share data)*

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Revenues: | | | | |
| Subscription | $318,934 | $223,208 | $877,035 | $603,576 |
| Professional services and other | 38,722 | 37,942 | 127,812 | 116,254 |
| Total revenues | 357,656 | 261,150 | 1,004,847 | 719,830 |
| Cost of revenues[1]: | | | | |
| Subscription | 61,566 | 46,053 | 170,707 | 133,889 |
| Professional services and other | 41,271 | 35,835 | 123,039 | 104,615 |
| Total cost of revenues | 102,837 | 81,888 | 293,746 | 238,504 |
| Gross profit | 254,819 | 179,262 | 711,101 | 481,326 |
| Operating expenses[1]: | | | | |
| Sales and marketing | 166,491 | 117,899 | 511,607 | 364,530 |
| Research and development | 75,018 | 55,822 | 211,306 | 158,946 |
| General and administrative | 40,085 | 33,581 | 117,393 | 93,357 |
| Legal settlements | — | — | 270,000 | — |
| Total operating expenses | 281,594 | 207,302 | 1,110,306 | 616,833 |
| Loss from operations | (26,775) | (28,040) | (399,205) | (135,507) |
| Interest expense | (8,389) | (7,839) | (24,746) | (23,124) |
| Interest and other income (expense), net | 1,783 | (3,952) | 4,745 | 1,273 |
| Loss before provision for income taxes | (33,381) | (39,831) | (419,206) | (157,358) |
| Provision for income taxes | 2,877 | 1,199 | 9 | 3,690 |
| Net loss | $(36,258) | $(41,030) | $(419,215) | $(161,048) |
| Net loss per share - basic and diluted | $(0.22) | $(0.26) | $(2.56) | $(1.04) |
| Weighted-average shares used to compute net loss per share - basic and diluted | 165,378,836 | 156,930,506 | 163,767,329 | 154,352,037 |
| Other comprehensive gain (loss): | | | | |
| Foreign currency translation adjustments | $203 | $(2,689) | $(1,106) | $(3,028) |
| Unrealized gain (loss) on investments, net of tax | (615) | (111) | 1,523 | 69 |
| Other comprehensive gain (loss), net of tax | (412) | (2,800) | 417 | (2,959) |
| Comprehensive loss | $(36,670) | $(43,830) | $(418,798) | $(164,007) |

(1) Includes stock-based compensation as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Cost of revenues: | | | | |
| Subscription | $7,140 | $5,951 | $20,698 | $17,183 |
| Professional services and other | 7,150 | 5,804 | 20,045 | 16,788 |
| Sales and marketing | 31,898 | 26,011 | 95,757 | 74,690 |
| Research and development | 21,376 | 18,130 | 62,956 | 51,703 |
| General and administrative | 13,523 | 9,215 | 35,004 | 29,167 |
| Total stock-based compensation | $81,087 | $65,111 | $234,460 | $189,531 |

*See accompanying notes to condensed consolidated financial statements*

**SERVICENOW, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited)**
*(in thousands)*

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2016 | 2015 |
| **Cash flows from operating activities:** | | |
| Net loss | $(419,215) | $(161,048) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 59,716 | 43,957 |
| Amortization of premiums on investments | 3,745 | 5,380 |
| Amortization of deferred commissions | 57,742 | 48,055 |
| Amortization of debt discount and issuance costs | 24,746 | 23,124 |
| Stock-based compensation | 234,460 | 189,531 |
| Deferred income tax | (5,095) | — |
| Other | (857) | (5,393) |
| Changes in operating assets and liabilities, net of effect of business combinations: | | |
| Accounts receivable | (15,761) | (5,303) |
| Deferred commissions | (79,190) | (54,168) |
| Prepaid expenses and other assets | (11,733) | (8,915) |
| Accounts payable | (8,625) | 8,312 |
| Deferred revenue | 151,019 | 115,812 |
| Accrued expenses and other liabilities | 36,282 | 11,856 |
| Net cash provided by operating activities(1) | 27,234 | 211,200 |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | (84,112) | (62,588) |
| Business combinations, net of cash acquired | (34,297) | (1,100) |
| Purchases of other intangibles | (14,850) | — |
| Purchases of investments | (434,397) | (543,167) |
| Purchases of strategic investments | — | (10,000) |
| Sales of investments | 266,288 | 242,631 |
| Maturities of investments | 218,452 | 203,632 |
| Restricted cash | (322) | (408) |
| Net cash used in investing activities | (83,238) | (171,000) |
| **Cash flows from financing activities:** | | |
| Proceeds related to deferred payments on purchase of other intangibles | 4,100 | — |
| Payments related to deferred payments on purchase of other intangibles | (1,025) | — |
| Proceeds from employee stock plans | 55,063 | 73,347 |
| Taxes paid related to net share settlement of equity awards | (88,567) | (12,603) |
| Payments on financing obligation | (336) | (112) |
| Net cash (used in) provided by financing activities(1) | (30,765) | 60,632 |
| Foreign currency effect on cash and cash equivalents | (469) | (4,214) |
| Net (decrease) increase in cash and cash equivalents | (87,238) | 96,618 |
| Cash and cash equivalents at beginning of period | 412,305 | 252,455 |
| Cash and cash equivalents at end of period | $325,067 | $349,073 |
| **Supplemental disclosures of non-cash investing activities:** | | |
| Property and equipment included in accounts payable and accrued expenses | $9,691 | $14,381 |

(1) During the nine months ended September 30, 2016, we early adopted Accounting Standards Update 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." Refer to Note 2 Recent Accounting Pronouncements for further details. This adoption resulted in a $1.2 million increase in net cash provided by operating activities and a corresponding $1.2 million decrease in net cash provided by financing activities for the nine months ended September 30, 2015.

*See accompanying notes to condensed consolidated financial statements*

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**SERVICENOW, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(Unaudited)**

*Unless the context requires otherwise, references in this report to "ServiceNow," the "Company", "we," "us," and "our" refer to ServiceNow, Inc. and its consolidated subsidiaries.*

## (1) Description of the Business

ServiceNow is a leading provider of enterprise cloud computing solutions that define, structure, manage and automate services across the global enterprise. Our mission is to help the modern enterprise operate faster and be more scalable by applying a service-oriented lens to the activities, tasks and processes that comprise day-to-day work life.

## (2) Summary of Significant Accounting Policies

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared in accordance with the applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles, or GAAP, for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for fair statement of results for the interim periods presented have been included. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the year ended December 31, 2016 or for other interim periods or for future years. The condensed consolidated balance sheet as of December 31, 2015 is derived from audited financial statements as of that date, however, it does not include all of the information and footnotes required by GAAP for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on February 25, 2016.

***Principles of Consolidation***

The condensed consolidated financial statements have been prepared in conformity with GAAP and include our accounts and the accounts of our wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

***Prior Period Reclassification***

Certain reclassifications of prior period amounts have been made to conform to the current period presentation.

***Use of Estimates***

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Warranties and Indemnification***

Our cloud computing solutions are typically warranted to perform in material conformance with their specifications.

We include service level commitments to our customers that permit those customers to receive credits in the event we fail to meet those service levels. We establish an accrual based on an evaluation of the known service disruptions. Service level credit accrual charges are recorded against revenue and were not material for all periods presented.

We have also agreed to indemnify our directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person’s service as a director or officer, including any action by us, arising out of that person’s services as a director or officer of our company or that person’s services provided to any other company or enterprise at our request. We maintain director and officer insurance coverage that may enable us to recover a portion of any future amounts paid. The fair values of these obligations are not material as of each balance sheet date.

Our agreements include provisions indemnifying customers against intellectual property and other third-party claims. We have not incurred any costs as a result of such indemnification obligations and have not recorded any liabilities related to such obligations in the condensed consolidated financial statements.

***New Accounting Pronouncements Adopted in 2016***

In March 2016, the FASB issued ASU 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This standard is effective for our interim and annual reporting periods beginning January 1, 2017, and early adoption is permitted. We elected to early adopt this standard in the quarter ended June 30, 2016. The impact of the early adoption was as follows:

- The standard eliminates additional paid in capital (APIC) pools and requires excess tax benefits and tax deficiencies to be recorded in the income statement as a discrete item when the awards vest or are settled. The adoption of this guidance on a prospective basis resulted in the recognition of excess tax benefits in our provision for income taxes of $0.3 million and $2.0 million for the three and nine months ended September 30, 2016, respectively.

- The standard requires excess tax benefits to be recognized regardless of whether the benefit reduces taxes payable. The adoption of this guidance on a modified retrospective basis resulted in the recognition of a cumulative-effect adjustment of $11.4 million that reduced our accumulated deficit and increased our foreign long-term deferred income tax as of January 1, 2016. The previously unrecognized U.S. excess tax effects were recorded as a deferred tax asset net of a valuation allowance.

- We have elected to continue to estimate forfeitures expected to occur to determine the amount of stock-based compensation cost to be recognized in each period. As such, the guidance relating to forfeitures did not have an impact on our accumulated deficit as of January 1, 2016.

- We elected to apply the statement of cash flows guidance that cash flows related to excess tax benefits be presented as an operating activity retrospectively, which resulted in a $1.2 million increase to net cash provided by operating activities and a corresponding decrease to net cash provided by financing activities in the accompanying condensed consolidated statement of cash flows for the nine months ended September 30, 2015, as compared to the amounts previously reported.

- The statement of cash flows guidance that cash flows related to employee taxes paid for withheld shares be presented as a financing activity had no impact on our condensed consolidated financial statements as we have historically presented such cash flows as a financing activity.

In September 2015, the FASB issued ASU 2015-16, “Simplifying the Accounting for Measurement-Period Adjustments (Topic 805),” which eliminates the requirement to restate prior period financial statements for measurement period adjustments in business combinations. This new standard requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. We adopted this standard during the three months ended March 31, 2016 on a prospective basis and the adoption had no material impact on our condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement." ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes software. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. We adopted this standard during the three months ended March 31, 2016 on a prospective basis and the adoption had no material impact on our condensed consolidated financial statements.

***Pending Accounting Pronouncements***

In October 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory," which includes a revision of the accounting for the income tax consequences of intra-entity transfers of assets other than inventory to reduce the complexity in accounting standards. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017, and early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," which provides guidance on eight specific cash flow issues. Among these issues, this standard requires, at the settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowings, the portion of the cash payment attributable to the accreted interest related to the debt discount to be classified as cash flows for operating activities, and the portion of the cash payments attributable to the principal to be classified as cash outflows for financing activities. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017, and early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which requires a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This standard is effective for our interim and annual reporting periods beginning after December 15, 2019. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets, and to recognize on the income statement the expenses in a manner similar to current practice. This new standard is effective for our interim and annual periods beginning January 1, 2019 and early adoption is permitted. While we are currently evaluating the impact of this standard on our condensed consolidated financial statements, we anticipate this standard will have a material impact on our condensed consolidated balance sheets given that we have operating lease commitments of approximately $300 million as of September 30, 2016. However, we do not anticipate this standard will have a material impact on our condensed consolidated statements of comprehensive loss since the expense recognition under this new standard will be similar to current practice.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This new standard is effective for our interim and annual periods beginning January 1, 2018 and early adoption is not permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which will supersede virtually all existing revenue guidance. Under this standard, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This standard should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in the retained earnings. In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the principal versus agent guidance in the new revenue recognition standard. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which clarifies the guidance on accounting for licenses of intellectual property (IP) and identifying performance obligations in the new revenue recognition standard. In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," which amended the revenue recognition guidance regarding collectability, non-cash consideration, presentation of sales tax and transition. These new standards are effective for our interim and annual periods beginning January 1, 2018 and early adoption beginning January 1, 2017 is permitted. We are currently evaluating the impact of these standards on our condensed consolidated financial statements and have not yet selected the transition method.

## (3) Investments

### *Marketable Securities*

The following is a summary of our available-for-sale investment securities, excluding those securities classified within cash and cash equivalents on the consolidated balance sheets (in thousands):

| | September 30, 2016 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Available-for-sale securities: | | | | |
| Commercial paper | $61,726 | $ — | $— | $61,726 |
| Corporate notes and bonds | 629,143 | 513 | (553 ) | 629,103 |
| Certificates of deposit | 33,417 | — | — | 33,417 |
| U.S. government agency securities | 38,908 | 26 | (14 ) | 38,920 |
| Total available-for-sale securities | $763,194 | $ 539 | $ (567 ) | $763,166 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Available-for-sale securities: | | | | |
| Commercial paper | $32,430 | $ 2 | $(38 ) | $32,394 |
| Corporate notes and bonds | 617,054 | 7 | (2,027 ) | 615,034 |
| Certificates of deposit | 29,610 | 2 | (17 ) | 29,595 |
| U.S. government agency securities | 134,962 | 1 | (374 ) | 134,589 |
| Total available-for-sale securities | $814,056 | $ 12 | $(2,456 ) | $811,612 |

As of September 30, 2016, the contractual maturities of our investments did not exceed 24 months. The fair values of available-for-sale investments, by remaining contractual maturity, are as follows (in thousands):

| | September 30, 2016 |
|---|---|
| Due in 1 year or less | $481,813 |
| Due in 1 year through 2 years | 281,353 |
| Total | $763,166 |

We had certain available-for-sale securities in a gross unrealized loss position, substantially all of which had been in such position for less than 12 months. There were no impairments considered "other-than-temporary" as it is more likely than not we will hold the securities until maturity or a recovery of the cost basis. The following table shows the fair values and the gross unrealized losses of these securities, classified by the length of time that the securities have been in a continuous unrealized loss position, and aggregated by investment types (in thousands):

| | September 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Greater | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Corporate notes and bonds | $367,093 | $ (553 ) | $600 | $ — | $367,693 | $ (553 ) |
| U.S. government agency securities | 21,401 | (14 ) | — | — | 21,401 | (14 ) |
| Total | $388,494 | $ (567 ) | $600 | $ — | $389,094 | $ (567 ) |

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Greater | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Commercial paper | $24,913 | $(38) | $— | $— | $24,913 | $(38) |
| Corporate notes and bonds | 539,586 | (1,897) | 60,099 | (130) | 599,685 | (2,027) |
| Certificates of deposit | 19,750 | (17) | — | — | 19,750 | (17) |
| U.S. government agency securities | 132,581 | (374) | — | — | 132,581 | (374) |
| Total | $716,830 | $(2,326) | $60,099 | $(130) | $776,929 | $(2,456) |

***Strategic Investments***

We account for our investments in non-marketable equity securities of certain privately-held companies under the cost method, as we have less than a 20% ownership interest and we do not have the ability to exercise significant influence over the operations of these companies. The carrying value of these investments was $10.5 million as of September 30, 2016 and December 31, 2015, which is included in "Other assets" on the condensed consolidated balance sheets.

## (4) Fair Value Measurements

The following table presents our fair value hierarchy for our assets measured at fair value on a recurring basis at September 30, 2016 (in thousands):

| | Level 1 | Level 2 | Total |
|---|---|---|---|
| Cash equivalents: | | | |
| Money market funds | $114,850 | $— | $114,850 |
| Short-term investments: | | | |
| Commercial paper | — | 61,726 | 61,726 |
| Corporate notes and bonds | — | 376,862 | 376,862 |
| Certificates of deposit | — | 32,712 | 32,712 |
| U.S. government agency securities | — | 10,513 | 10,513 |
| Long-term investments: | | | |
| Corporate notes and bonds | — | 252,240 | 252,240 |
| Certificates of deposit | — | 705 | 705 |
| U.S. government agency securities | — | 28,408 | 28,408 |
| Total | $114,850 | $763,166 | $878,016 |

The following table presents our fair value hierarchy for our assets measured at fair value on a recurring basis at December 31, 2015 (in thousands):

| | Level 1 | Level 2 | Total |
|---|---|---|---|
| Cash equivalents: | | | |
| Money market funds | $263,515 | $— | $263,515 |
| Commercial paper | — | 2,000 | 2,000 |
| Corporate notes and bonds | — | 1,119 | 1,119 |
| Short-term investments: | | | |
| Commercial paper | — | 32,394 | 32,394 |
| Corporate notes and bonds | — | 303,567 | 303,567 |
| Certificates of deposit | — | 23,736 | 23,736 |
| U.S. government agency securities | — | 29,248 | 29,248 |
| Long-term investments: | | | |
| Corporate notes and bonds | — | 311,467 | 311,467 |
| Certificates of deposit | — | 5,859 | 5,859 |
| U.S. government agency securities | — | 105,341 | 105,341 |
| Total | $263,515 | $814,731 | $1,078,246 |

We determine the fair value of our security holdings based on pricing from our service provider and market prices from industry-standard independent data providers. Such market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs), such as yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures.

See Note 9 for the fair value measurement of our convertible senior notes.

## (5) Business Combinations

### *BrightPoint Security*

On June 3, 2016, we completed the acquisition of a privately-held company, BrightPoint Security, Inc. (BrightPoint), by acquiring all issued and outstanding common shares of BrightPoint for approximately $19.6 million in an all-cash transaction to expand our security operations solutions. The following table summarizes the allocation of the purchase price to the fair value of the tangible and intangible assets acquired and liabilities assumed as of the acquisition date:

| | Purchase Price Allocation (in thousands) | Useful Life (in years) |
|---|---|---|
| Intangible assets: | | |
| Developed technology | $8,100 | 6 |
| Customer contracts and related relationships | 500 | 1.5 |
| Goodwill | 15,258 | |
| Net tangible liabilities acquired | (1,339) | |
| Net deferred tax liabilities[(1)] | (2,890) | |
| Total purchase price | $19,629 | |

(1) Deferred tax liabilities, net primarily relates to purchased identifiable intangible assets and is shown net of deferred tax assets.

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***ITapp***

On April 8, 2016, we completed the acquisition of a privately-held company, ITapp Inc. (ITapp), by acquiring all issued and outstanding common shares of ITapp for approximately $14.5 million in an all-cash transaction to expand our IT operations management solutions. The following table summarizes the allocation of the purchase price to the fair value of the tangible and intangible assets acquired and liabilities assumed as of the acquisition date:

| | Purchase Price Allocation (in thousands) | Useful Life (in years) |
|---|---|---|
| Net tangible assets acquired | $ 140 | |
| Intangible assets: | | |
| Developed technology | 4,700 | 5 |
| Customer contracts and related relationships | 200 | 1.5 |
| Goodwill | 11,437 | |
| Net deferred tax liabilities | (2,015 ) | |
| Total purchase price | $ 14,462 | |

For both business combinations, the excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. We believe the goodwill represents the synergies expected from expanded market opportunities when integrating the acquired technologies with our offerings. The goodwill balance for both business combinations is not deductible for income tax purposes. Acquisition-related costs of $1.0 million are included in general and administrative expenses in our consolidated statements of comprehensive loss.

The results of operations of both BrightPoint and ITapp have been included in our condensed consolidated financial statements from their respective dates of purchase. These business combinations did not have a material impact on our condensed consolidated financial statements, and therefore historical and pro forma disclosures have not been presented.

**(6) Goodwill and Intangible Assets**

Goodwill balances are presented below (in thousands):

| | Carrying Amount |
|---|---|
| Balance as of December 31, 2015 | $ 55,669 |
| Goodwill acquired | 26,695 |
| Foreign currency translation adjustments | 2,061 |
| Balance as of September 30, 2016 | $ 84,425 |

Intangible assets consist of the following (in thousands):

| | September 30, 2016 | | |
|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Developed technology | $ 80,453 | $ (27,580 ) | $ 52,873 |
| Other | 9,275 | (1,422 ) | 7,853 |
| Total intangible assets | $ 89,728 | $ (29,002 ) | $ 60,726 |

| | December 31, 2015 | | |
|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Developed technology | $58,144 | $(17,463 ) | $40,681 |
| Other | 3,695 | (1,371 ) | 2,324 |
| Total intangible assets | $61,839 | $(18,834 ) | $43,005 |

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Amortization expense for intangible assets for the three months ended September 30, 2016 and 2015 was approximately $4.3 million and $2.9 million, respectively, and for the nine months ended September 30, 2016 and 2015 was approximately $10.9 million and $8.8 million, respectively.

**(7) Property and Equipment**

Property and equipment, net consists of the following (in thousands):

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| Computer equipment and software | $238,661 | $180,197 |
| Leasehold improvements | 35,418 | 31,659 |
| Furniture and fixtures | 29,981 | 26,017 |
| Building | 6,570 | 6,318 |
| Construction in progress | 5,088 | 1,886 |
| | 315,718 | 246,077 |
| Less: Accumulated depreciation | (139,612 ) | (101,363 ) |
| Total property and equipment, net | $176,106 | $144,714 |

Construction in progress consists primarily of leasehold improvements and in-process software development costs. Depreciation expense for the three months ended September 30, 2016 and 2015 was $17.9 million and $12.2 million, respectively, and for the nine months ended September 30, 2016 and 2015 was $48.7 million and $35.1 million, respectively.

**(8) Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consist of the following (in thousands):

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| Taxes payable | $11,452 | $9,080 |
| Bonuses and commissions | 46,253 | 33,124 |
| Accrued compensation | 25,724 | 17,089 |
| Other employee related liabilities | 18,602 | 21,529 |
| Other | 22,639 | 20,442 |
| Total accrued expenses and other current liabilities | $124,670 | $101,264 |

**(9) Convertible Senior Notes**

In November 2013, we issued 0% convertible senior notes due November 1, 2018 with an aggregate principal amount of $575 million, or the Notes. The Notes will not bear interest. The Notes mature on November 1, 2018 unless converted or repurchased in accordance with their terms prior to such date. We cannot redeem the Notes prior to maturity.

The Notes are unsecured obligations and do not contain any financial covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. Upon conversion, we may choose to pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock. We intend to settle the principal amount of the Notes with cash.

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The Notes are convertible up to 7.8 million shares of our common stock at an initial conversion rate of approximately 13.54 shares of common stock per $1,000 principal amount, which is equal to an initial conversion price of approximately $73.88 per share of common stock, subject to adjustment. Holders of the Notes may convert their Notes at their option at any time prior to the close of business on the business day immediately preceding July 1, 2018, only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on March 31, 2014 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

- during the five business day period after any five consecutive trading day period, or the measurement period, in which the trading price per $1,000 principal amount of the Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or

- upon the occurrence of specified corporate events.

On or after July 1, 2018, a holder may convert all or any portion of its notes at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date regardless of the foregoing conditions. Upon conversion, we will pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election.

The conversion price will be subject to adjustment in some events. Holders of the Notes who convert their notes in connection with certain corporate events that constitute a “make-whole fundamental change” are, under certain circumstances, entitled to an increase in the conversion rate. Additionally, in the event of a corporate event that constitutes a “fundamental change,” holders of the Notes may require us to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, at a purchase price equal to 100% of the principal amount of the Notes plus any accrued and unpaid interest.

In accounting for the issuance of the Notes, we separated the Notes into liability and equity components. The carrying cost of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes. The difference between the principal amount of the Notes and the proceeds allocated to the liability component, or the debt discount, is amortized to interest expense using the effective interest method over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the issuance of the Notes, we allocated the total amount incurred to the liability and equity components based on their relative fair values. Transaction costs attributable to the liability component are being amortized to interest expense over the term of the Notes, and transaction costs attributable to the equity component were netted with the equity component of the Notes in stockholders’ equity. The Notes consisted of the following (in thousands):

| | **September 30, 2016** | **December 31, 2015** |
|---|---|---|
| Liability: | | |
| Principal | $575,000 | $575,000 |
| Less: debt issuance cost and debt discount, net of amortization | (75,720 ) | (100,466 ) |
| Net carrying amount | $499,280 | $474,534 |

We consider the fair value of the Notes at September 30, 2016 and December 31, 2015 to be a Level 2 measurement. The estimated fair values of the Notes were $701.8 million and $741.8 million at September 30, 2016 and December 31, 2015, respectively (based on the closing trading price per $100 of the Notes on September 30, 2016 and December 31, 2015, respectively). The Notes were not convertible as of September 30, 2016 and December 31, 2015.

As of September 30, 2016, the remaining life of the Notes is 25 months. The following table sets forth total interest expense recognized related to the Notes (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Amortization of debt issuance cost | $450 | $420 | $1,327 | $1,240 |
| Amortization of debt discount | 7,939 | 7,419 | 23,419 | 21,884 |
| Total | $8,389 | $7,839 | $24,746 | $23,124 |
| Effective interest rate of the liability component | 6.5% | | | |

***Note Hedge***

To minimize the impact of potential economic dilution upon conversion of the Notes, we entered into convertible note hedge transactions, or the Note Hedge, with respect to our common stock concurrent with the issuance of the Notes. The Note Hedge covers approximately 7.8 million shares of our common stock at a strike price per share that corresponds to the initial conversion price of the Notes, subject to adjustment, and is exercisable upon conversion of the Notes. We paid an aggregate amount of $135.8 million for the Note Hedge. The Note Hedge will expire upon maturity of the Notes. The Note Hedge is intended to reduce the potential economic dilution upon conversion of the Notes in the event that the fair value per share of our common stock at the time of exercise is greater than the conversion price of the Notes. The Note Hedge is a separate transaction and is not part of the terms of the Notes. The Note Hedge does not impact earnings per share, as it was entered into to offset any dilution from the Notes.

***Warrants***

Separately, we entered into warrant transactions, or the Warrants, whereby we sold warrants to acquire up to 7.8 million shares of our common stock, at a strike price of $107.46 per share, subject to adjustment. We received aggregate proceeds of $84.5 million from the sale of the Warrants. If the average market value per share of our common stock for the reporting period, as measured under the Warrants, exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on our earnings per share. The Warrants are separate transactions and are not remeasured through earnings each reporting period. The Warrants are not part of the Notes or the Note Hedge, and have been accounted for as part of additional paid-in capital.

## (10) Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of tax, consist of the following (in thousands):

| | September 30, | December 31, |
|---|---|---|
| | 2016 | 2015 |
| Foreign currency translation adjustment | $(15,544) | $(14,438) |
| Net unrealized loss on investments, net of tax | (921) | (2,444) |
| Accumulated other comprehensive loss | $(16,465) | $(16,882) |

Reclassification adjustments out of accumulated other comprehensive loss into net loss were immaterial for all periods presented.

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## (11) Stockholders' Equity

***Common Stock***

We were authorized to issue 600,000,000 shares of common stock as of September 30, 2016. Holders of our common stock are not entitled to receive dividends unless declared by our board of directors. As of September 30, 2016, we had 166,011,100 shares of common stock outstanding and had reserved shares of common stock for future issuance as follows:

| | September 30, 2016 |
|---|---|
| Stock option plans: | |
| Options outstanding | 6,475,548 |
| RSUs | 12,834,324 |
| Stock awards available for future grants: | |
| 2012 Equity Incentive Plan[1] | 21,051,913 |
| 2012 Employee Stock Purchase Plan[1] | 8,566,803 |
| Total reserved shares of common stock for future issuance | 48,928,588 |

(1) Refer to Note 12 for a description of these plans.

During the nine months ended September 30, 2016 and 2015, we issued a total of 5,225,336 shares and 8,586,233 shares, respectively, from stock option exercises, vesting of restricted stock units, or RSUs, net of employee payroll taxes and purchases from the employee stock purchase plan, or ESPP.

## (12) Stock Awards

We have a 2005 Stock Option Plan, or 2005 Plan, which provides for grants of stock awards, including options to purchase shares of common stock, stock purchase rights and RSUs to certain employees, officers, directors and consultants.

Our 2012 Equity Incentive Plan, or 2012 Plan, provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, RSUs, performance-based stock awards and other forms of equity compensation, or collectively, stock awards. In addition, the 2012 Plan provides for the grant of performance cash awards. Incentive stock options may be granted only to employees. All other awards may be granted to employees, including officers, as well as directors and consultants. The share reserve may increase to the extent outstanding stock options under the 2005 Plan expire or terminate unexercised. The share reserve also automatically increases on January 1 of each year until January 1, 2022, by up to 5% of the total number of shares of common stock outstanding on December 31 of the preceding year as determined by the board of directors. On January 1, 2016, 8,039,288 shares of common stock were automatically added to the 2012 Plan pursuant to the provision described in the preceding sentence.

Our 2012 Employee Stock Purchase Plan, or 2012 ESPP, authorizes the issuance of shares of common stock pursuant to purchase rights granted to our employees. The price at which common stock is purchased under the 2012 ESPP is equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. Offering periods are six months long and begin on February 1 and August 1 of each year. The number of shares of common stock reserved for issuance automatically increases on January 1 of each year until January 1, 2022, by up to 1% of the total number of shares of common stock outstanding on December 31 of the preceding year as determined by the board of directors. On January 1, 2016, 1,607,858 shares of common stock were automatically added to the 2012 ESPP pursuant to the provision described in the preceding sentence.

***Stock Options***

A summary of the stock option activity for the nine months ended September 30, 2016 is as follows:

| | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at December 31, 2015 | 8,255,554 | $ 16.65 | | |
| Granted | 169,400 | 65.92 | | |
| Exercised | (579,504 ) | 5.28 | | $35,876 |
| Canceled | (126,735 ) | 58.05 | | |
| Outstanding at March 31, 2016 | 7,718,715 | 17.90 | | |
| Granted | 131,835 | 68.36 | | |
| Exercised | (828,327 ) | 17.18 | | $43,757 |
| Canceled | (119,321 ) | 52.26 | | |
| Outstanding at June 30, 2016 | 6,902,902 | 18.36 | | |
| Granted | 232,750 | 74.47 | | |
| Exercised | (477,802 ) | 15.69 | | $28,345 |
| Canceled | (182,302 ) | 58.41 | | |
| Outstanding at September 30, 2016 | 6,475,548 | $ 19.44 | 5.54 | $386,791 |
| Vested and expected to vest as of September 30, 2016 | 6,370,923 | $ 18.62 | 5.48 | $385,785 |
| Vested and exercisable as of September 30, 2016 | 5,548,381 | $ 11.91 | 5.01 | $373,084 |

Aggregate intrinsic value represents the difference between the estimated fair value of our common stock and the exercise price of outstanding, in-the-money options. The weighted-average grant date fair value per share of options granted was $27.90 for the nine months ended September 30, 2016. The total fair value of stock options vested during the nine months ended September 30, 2016 was $14.2 million.

As of September 30, 2016, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options was approximately $20.7 million. The weighted-average remaining vesting period of unvested stock options at September 30, 2016 was 2.83 years.

***RSUs***

A summary of RSU activity for the nine months ended September 30, 2016 is as follows:

| | Number of Shares | Weighted Average Grant Date Fair Value (Per Share) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|
| Outstanding at December 31, 2015 | 12,417,805 | $63.38 | |
| Granted | 3,822,832 | 51.11 | |
| Vested | (1,708,179 ) | 58.42 | $89,516 |
| Forfeited | (370,545 ) | 64.43 | |
| Outstanding at March 31, 2016 | 14,161,913 | 60.64 | |
| Granted | 805,680 | 67.75 | |
| Vested | (1,285,704 ) | 53.70 | $86,693 |
| Forfeited | (407,451 ) | 63.31 | |
| Outstanding at June 30, 2016 | 13,274,438 | 61.66 | |
| Granted | 1,423,601 | 74.62 | |
| Vested | (1,132,142 ) | 63.56 | $85,816 |
| Forfeited | (731,573 ) | 61.29 | |
| Non-vested and outstanding at September 30, 2016 | 12,834,324 | $62.95 | $1,015,837 |
| Expected to vest as of September 30, 2016 | 10,843,628 | | $858,273 |

RSUs granted to employees under the 2005 Plan and the 2012 Plan generally vest over a four-year period. As of September 30, 2016, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested RSUs was approximately $603.8 million and the weighted-average remaining vesting period was 2.84 years.

**(13) Net Loss Per Share**

The following table presents the calculation of basic and diluted net loss per share (in thousands, except share and per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Numerator: | | | | |
| Net loss | $(36,258 ) | $(41,030 ) | $(419,215 ) | $(161,048 ) |
| Denominator: | | | | |
| Weighted-average shares outstanding—basic and diluted | 165,378,836 | 156,930,506 | 163,767,329 | 154,352,037 |
| Net loss per share—basic and diluted: | $(0.22 ) | $(0.26 ) | $(2.56 ) | $(1.04 ) |

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Potentially dilutive securities that are not included in the calculation of diluted net loss per share because doing so would be antidilutive are as follows:

| | September 30, | |
|---|---|---|
| | 2016 | 2015 |
| Common stock options | | |