Workday, Inc.
Form 10-Q
September 04, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended July 31, 2015
OR
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-35680

Workday, Inc.
(Exact name of registrant as specified in its charter)

Delaware	20-2480422
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
6230 Stoneridge Mall Road Pleasanton, California 94588 (Address of principal executive offices)	
Telephone Number (925) 951-9000 (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 (the "Exchange Act") 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 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.

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 Exchange Act). Yes ¨ No x
As of August 31, 2015, there were approximately 192 million shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Workday, Inc.
Condensed Consolidated Balance Sheets
(in thousands)
(unaudited)

	July 31, 2015	January 31, 2015 [1]
Assets		
Current assets:		
Cash and cash equivalents	$230,578	$298,192
Marketable securities	1,676,351	1,559,517
Accounts receivable, net	156,282	188,357
Deferred costs	18,905	20,471
Prepaid expenses and other current assets	58,412	42,502
Total current assets	2,140,528	2,109,039
Property and equipment, net	172,701	140,136
Deferred costs, noncurrent	20,787	20,998
Goodwill and acquisition-related intangible assets, net	42,953	34,779
Other assets	66,915	53,681
Total assets	$2,443,884	$2,358,633
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$23,668	$10,623
Accrued expenses and other current liabilities	31,706	24,132
Accrued compensation	48,347	56,152
Capital leases	743	3,207
Unearned revenue	601,807	547,151
Total current liabilities	706,271	641,265
Convertible senior notes, net	502,045	490,501
Unearned revenue, noncurrent	81,281	85,593
Other liabilities	22,312	15,299
Total liabilities	1,311,909	1,232,658
Stockholders' equity:		
Common stock	190	186
Additional paid-in capital	2,084,815	1,948,300
Accumulated other comprehensive income (loss)	320	(140)
Accumulated deficit	(953,350)	(822,371)
Total stockholders' equity	1,131,975	1,125,975
Total liabilities and stockholders' equity	$2,443,884	$2,358,633

[1] Amounts as of January 31, 2015 were derived from the January 31, 2015 audited financial statements.
See Notes to Condensed Consolidated Financial Statements.

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Workday, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share data)
(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Revenues:				
Subscription services	$223,742	$143,652	$424,735	$267,059
Professional services	58,954	43,128	108,918	79,458
Total revenues	282,696	186,780	533,653	346,517
Costs and expenses[(1)]:				
Costs of subscription services	35,287	24,373	67,069	45,832
Costs of professional services	56,792	41,267	102,924	77,227
Product development	115,345	77,464	214,680	142,635
Sales and marketing	106,430	78,523	201,325	146,690
General and administrative	36,482	26,922	68,699	47,985
Total costs and expenses	350,336	248,549	654,697	460,369
Operating loss	(67,640)	(61,769)	(121,044)	(113,852)
Other expense, net	(3,779)	(6,953)	(11,015)	(13,952)
Loss before provision for (benefit from) income taxes	(71,419)	(68,722)	(132,059)	(127,804)
Provision for (benefit from) income taxes	(1,998)	493	(1,080)	800
Net loss	$(69,421)	$(69,215)	$(130,979)	$(128,604)
Net loss per share, basic and diluted	$(0.37)	$(0.38)	$(0.70)	$(0.70)
Weighted-average shares used to compute net loss per share, basic and diluted	189,360	184,319	188,382	183,733

(1) Costs and expenses include share-based compensation expenses as follows:

Costs of subscription services	$3,173	$1,608	$5,221	$2,663
Costs of professional services	5,144	3,519	8,598	5,717
Product development	28,632	16,737	49,443	27,605
Sales and marketing	13,222	7,377	21,587	14,129
General and administrative	14,593	11,541	27,189	19,542

See Notes to Condensed Consolidated Financial Statements.

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Workday, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Net loss	$(69,421)	$(69,215)	$(130,979)	$(128,604)
Other comprehensive income (loss), net of tax:				
Net change in foreign currency translation adjustment	(227)	(15)	(200)	24
Net change in unrealized gains (losses) on available-for-sale investments	(192)	(503)	(337)	(330)
Net change in market value of effective foreign currency forward exchange contracts	1,018	—	997	—
Other comprehensive income (loss), net of tax	599	(518)	460	(306)
Comprehensive loss	$(68,822)	$(69,733)	$(130,519)	$(128,910)

See Notes to Condensed Consolidated Financial Statements.

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Workday, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Cash flows from operating activities				
Net loss	$(69,421)	$(69,215)	$(130,979)	$(128,604)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Depreciation and amortization	19,888	14,474	38,457	26,997
Share-based compensation expenses	64,764	40,782	112,038	69,656
Amortization of deferred costs	7,735	4,421	12,360	8,373
Amortization of debt discount and issuance costs	6,336	6,002	12,586	11,922
Gain on sale of cost method investment	(3,220)	—	(3,220)	—
Other	(2,119)	242	(1,382)	846
Changes in operating assets and liabilities, net of business combinations:				
Accounts receivable	(27,570)	(1,441)	32,147	(8,454)
Deferred costs	(7,082)	(6,433)	(10,583)	(9,896)
Prepaid expenses and other assets	(7,806)	(2,748)	(15,476)	(10,098)
Accounts payable	1,428	(23)	4,180	(2,453)
Accrued expense and other liabilities	2,913	(14,602)	9,098	(13,511)
Unearned revenue	29,665	19,530	50,344	67,908
Net cash provided by (used in) operating activities	15,511	(9,011)	109,570	12,686
Cash flows from investing activities				
Purchases of marketable securities	(476,470)	(365,779)	(862,045)	(1,036,185)
Maturities of marketable securities	429,186	414,242	710,593	767,472
Sales of available-for-sale securities	19,524	8,138	29,524	8,138
Business combinations, net of cash acquired	(7,961)	—	(7,961)	(26,317)
Purchases of property and equipment	(25,792)	(28,409)	(55,972)	(38,282)
Purchases of cost method investments	(15,750)	(10,000)	(15,750)	(10,000)
Sale of cost method investment	3,538	—	3,538	—
Other	—	—	—	1,000
Net cash provided by (used in) investing activities	(73,725)	18,192	(198,073)	(334,174)
Cash flows from financing activities				
Proceeds from issuance of common stock from employee equity plans	19,172	15,169	22,736	18,165
Principal payments on capital lease obligations	(1,016)	(4,418)	(2,464)	(7,162)
Shares repurchased for tax withholdings on vesting of restricted stock	—	(3,284)	—	(8,291)
Other	362	—	779	60
Net cash provided by (used in) financing activities	18,518	7,467	21,051	2,772
Effect of exchange rate changes	(210)	(15)	(162)	24
Net increase (decrease) in cash and cash equivalents	(39,906)	16,633	(67,614)	(318,692)
Cash and cash equivalents at the beginning of period	270,484	246,001	298,192	581,326
Cash and cash equivalents at the end of period	$230,578	$262,634	$230,578	$262,634

Supplemental cash flow data				
Cash paid for interest	$3,211	$3,369	$3,244	$3,558
Cash paid for taxes	418	120	1,034	120
Non-cash investing and financing activities:				
Vesting of early exercise stock options	$472	$471	$944	$944
Purchases of property and equipment, accrued but not paid	18,642	12,171	18,642	12,171

See Notes to Condensed Consolidated Financial Statements

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Workday, Inc.
Notes to Condensed Consolidated Financial Statements
Note 1. Overview and Basis of Presentation
Company and Background
Workday provides financial management, human capital management, and analytics applications designed for the world's largest companies, educational institutions, and government agencies. We offer innovative and adaptable technology focused on the consumer Internet experience and cloud delivery model. Our applications are designed for global enterprises to manage complex and dynamic operating environments. We provide our customers highly adaptable, accessible and reliable applications to manage critical business functions that enable them to optimize their financial and human capital resources. We were originally incorporated in March 2005 in Nevada and in June 2012, we reincorporated in Delaware. As used in this report the terms "Workday," "registrant," "we," "us," and "our" mean Workday, Inc. and its subsidiaries unless the context indicates otherwise.
Basis of Presentation
The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. The condensed consolidated financial statements include the results of Workday, Inc. and its wholly-owned subsidiaries. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. In the opinion of our management, the information contained herein reflects all adjustments necessary for a fair presentation of Workday’s results of operations, financial position and cash flows. All such adjustments are of a normal, recurring nature. The results of operations for the three and six months ended July 31, 2015 shown in this report are not necessarily indicative of results to be expected for the full year ending January 31, 2016. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended January 31, 2015, filed on March 25, 2015. There have been no changes to our significant accounting policies described in the annual report that have had a material impact on our condensed consolidated financial statements and related notes.
Certain prior year amounts related to cost method investments have been reclassified within Note 6 of the notes to the condensed consolidated financial statements. The reclassifications had no effect on total Other assets as previously reported.
Use of Estimates
The preparation of condensed consolidated financial statements in conformity with GAAP requires us 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 condensed consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. These estimates include, but are not limited to, the determination of the relative selling prices for our services, the recoverability of deferred commissions, certain assumptions used in the valuation of equity awards and the fair value of assets acquired and liabilities assumed through business combinations. Actual results could differ from those estimates and such differences could be material to our condensed consolidated financial position and results of operations.
Segment Information
We operate in one operating segment, cloud applications. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker, who is our chief executive officer, in deciding how to allocate resources and assessing performance. Our chief operating decision maker allocates resources and assesses performance based upon discrete financial information at the consolidated level. Since we operate in one operating segment, all required financial segment information can be found in the condensed consolidated financial statements.
Recent Accounting Pronouncements
On May 28, 2014, the FASB issued ASU 2014-9 regarding ASC Topic 606, Revenue from Contracts with Customers. The standard 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. The guidance will be effective for our fiscal year beginning February 1, 2018. Early adoption is permitted. We are currently evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

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In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). The amendments in ASU 2015-03 require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. ASU 2015-03 is effective for annual and interim periods beginning on or after December 15, 2015. Early adoption is permitted. As of July 31, 2015, we have $8 million of net deferred financing costs that would be reclassified from a long-term asset to a reduction in the carrying amount of our debt.

Note 2. Marketable Securities

At July 31, 2015, marketable securities consisted of the following (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
U.S. agency obligations	$1,380,038	$258	$(40)	$1,380,256
U.S. treasury securities	115,274	29	(12)	115,291
U.S. corporate securities	100,928	2	(64)	100,866
Commercial paper	79,938	—	—	79,938
Money market funds	141,243	—	—	141,243
	$1,817,421	$289	$(116)	$1,817,594
Included in cash and cash equivalents	$141,243	$—	$—	$141,243
Included in marketable securities	$1,676,178	$289	$(116)	$1,676,351

At January 31, 2015, marketable securities consisted of the following (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
U.S. agency obligations	$1,303,829	$422	$(16)	$1,304,235
U.S. treasury securities	180,559	91	(1)	180,649
U.S. corporate securities	99,618	27	(13)	99,632
Commercial paper	89,984	—	—	89,984
Money market funds	142,137	—	—	142,137
	$1,816,127	$540	$(30)	$1,816,637
Included in cash and cash equivalents	$257,120	$—	$—	$257,120
Included in marketable securities	$1,559,007	$540	$(30)	$1,559,517

We do not believe the unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence, which includes our intent to hold these investments to maturity as of July 31, 2015. The unrealized losses on marketable securities which have been in a net loss position for twelve months or greater were not material as of July 31, 2015. We classify our marketable securities as available-for-sale at the time of purchase and reevaluate such classification as of each balance sheet date. We may sell these securities at any time for use in current operations or for other purposes, such as consideration for acquisitions, even if they have not yet reached maturity. As a result, we classify our investments, including securities with maturities beyond twelve months as current assets in the accompanying condensed consolidated balance sheets. Marketable securities on the condensed consolidated balance sheets consist of securities with original maturities at the time of purchase greater than three months and the remainder of the securities is reflected in cash and cash equivalents. During the three and six months ended July 31, 2015, we sold $20 million and $30 million, respectively, of our marketable securities and the realized gains from the sales are immaterial.

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Note 3. Deferred Costs

Deferred costs consisted of the following (in thousands):

	July 31, 2015	January 31, 2015
Current:		
Deferred professional service costs	$915	$3,606
Deferred sales commissions	17,990	16,865
Total	$18,905	$20,471
Noncurrent:		
Deferred professional service costs	$801	$1,254
Deferred sales commissions	19,986	19,744
Total	$20,787	$20,998

Note 4. Property and Equipment, Net

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

	July 31, 2015	January 31, 2015
Computers, equipment and software	$178,942	$139,569
Computers, equipment and software acquired under capital leases	32,302	34,112
Furniture and fixtures	16,837	13,082
Leasehold improvements	69,157	47,496
	297,238	234,259
Less accumulated depreciation and amortization	(124,537)	(94,123)
Property and equipment, net	$172,701	$140,136

Depreciation expense totaled $17 million and $11 million for the three months ended July 31, 2015 and 2014, respectively, and $33 million and $21 million for the six months ended July 31, 2015 and 2014, respectively. These amounts include depreciation of assets recorded under capital leases of $1 million and $2 million for the three months ended July 31, 2015 and 2014, respectively, and $2 million and $5 million for the six months ended July 31, 2015 and 2014, respectively.

Note 5. Goodwill and Acquisition-related Intangible Assets, Net

Developed technology from acquisitions is typically amortized over a useful life of three years. The future estimated amortization related to the acquired developed technology is $1 million and $2 million for fiscal 2016 and 2017, respectively. Goodwill amounts are not amortized, but rather tested for impairment at least annually during the last three months of the fiscal year.

Goodwill and acquisition-related intangible assets, net consisted of the following (in thousands):

	July 31, 2015	January 31, 2015
Acquired developed technology	$5,460	$4,200
Customer relationship assets	338	338
	5,798	4,538
Less accumulated amortization	(2,775)	(2,071)
Acquisition-related intangible assets, net	3,023	2,467
Goodwill	39,930	32,312
Goodwill and acquisition-related intangible assets, net	$42,953	$34,779

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Note 6. Other Assets

Other assets consisted of the following (in thousands):

	July 31, 2015	January 31, 2015
Cost method investments	$27,892	$12,910
Acquired land leasehold interest, net	9,833	9,886
Issuance costs of convertible senior notes, net	7,502	8,543
Technology patents, net	3,481	3,942
Other	18,207	18,400
Total	$66,915	$53,681

Amortization expense on our land leasehold interest and technology patents was $0.2 million for the three months ended July 31, 2015, $0.3 million for the three months ended July 31,2014 and $0.5 million for each of the six month periods ended July 31, 2015 and 2014.

Note 7. Fair Value Measurements

We measure our financial assets and liabilities at fair value at each reporting period using a fair value hierarchy that requires that we 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.

Financial Assets

We value our marketable securities using quoted prices for identical instruments in active markets when available. If we are unable to value our marketable securities using quoted prices for identical instruments in active markets, we value our investments using independent reports that utilize quoted market prices for comparable instruments. We validate, on a sample basis, the derived prices provided by the independent pricing vendors by comparing their assessment of the fair values of our investments against the fair values of the portfolio balances of another third-party professional's pricing service. To date, all of our marketable securities can be valued using one of these two methodologies.

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Based on our valuation of our marketable securities, we concluded that they are classified in either Level 1 or Level 2 and we have no financial assets or liabilities measured using Level 3 inputs. The following tables present information about our assets that are measured at fair value on a recurring basis using the above input categories (in thousands):

	Fair Value Measurements as of July 31, 2015		
Description	Level 1	Level 2	Total
U.S. agency obligations	$—	$1,380,256	$1,380,256
U.S. treasury securities	115,291	—	115,291
U.S. corporate securities	—	100,866	100,866
Commercial paper	—	79,938	79,938
Money market funds	141,243	—	141,243
	$256,534	$1,561,060	$1,817,594
Included in cash and cash equivalents			$141,243
Included in marketable securities			$1,676,351

	Fair Value Measurements as of January 31, 2015		
Description	Level 1	Level 2	Total
U.S. agency obligations	$—	$1,304,235	$1,304,235
U.S. treasury securities	180,649	—	180,649
U.S. corporate securities	—	99,632	99,632
Commercial paper	—	89,984	89,984
Money market funds	142,137	—	142,137
	$322,786	$1,493,851	$1,816,637
Included in cash and cash equivalents			$257,120
Included in marketable securities			$1,559,517

Financial Liabilities

The carrying amounts and estimated fair values of financial instruments not recorded at fair value are as follows (in thousands):

	July 31, 2015		January 31, 2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
0.75% Convertible senior notes	$302,539	$417,594	$295,276	$407,750
1.50% Convertible senior notes	199,506	310,469	195,225	299,063

The difference between the principal amount of the notes, $350 million for the 0.75% convertible senior notes and $250 million for the 1.50% convertible senior notes, and the carrying value represents the unamortized debt discount (see Note 8). The estimated fair value of the convertible senior notes, which we have classified as Level 2 financial instruments, was determined based on the quoted bid price of the convertible senior notes in an over-the-counter market on July 31, 2015 and January 31, 2015.

Based on the closing price of our common stock of $84.33 on July 31, 2015, the if-converted value of the 0.75% convertible senior notes and the if-converted value of the 1.50% convertible senior notes was greater than their respective principal amounts.

Derivative Financial Instruments

We conduct business on a global basis in multiple foreign currencies, subjecting the Company to foreign currency risk. To mitigate this risk, we utilize hedging contracts as described below. We do not enter into any derivatives for trading or speculative purposes.

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We are subject to master netting agreements with certain counterparties of the foreign exchange contracts, under which we are permitted to net settle transactions of the same currency with a single net amount payable by one party to the other. It is our policy to present the derivatives gross in the condensed consolidated balance sheets. Our foreign currency forward contracts are not subject to any credit contingent features or collateral requirements and we do not believe we are subject to significant counterparty concentration risk given the short-term nature, volume, and size of the derivative contracts outstanding.

Cash flow hedges

We are exposed to foreign currency fluctuations resulting from customer contracts denominated in foreign currencies. We initiated a hedging program in the first quarter of the current fiscal year by entering into foreign currency forward contracts related to certain customer contracts. We designate these forward contracts as cash flow hedging instruments as the accounting criteria for such designation have been met. The effective portion of the gains or losses resulting from changes in the fair value of these hedges is recorded in Accumulated other comprehensive income (loss) on the condensed consolidated balance sheets and will be subsequently reclassified to the related revenue line item in the condensed consolidated statements of operations in the same period that the underlying revenues are earned. Interest charges on our forward contracts are excluded from the assessment of hedge effectiveness and are recorded as incurred in Other expense, net in the condensed consolidated statements of operations.

As of July 31, 2015, we had foreign currency forward contracts designed as cash flow hedges with a total notional value of $51 million which have maturities not greater than 15 months. The notional value represents the amount that will be bought or sold upon maturity of the forward contract. As of July 31, 2015, the fair value amount of the derivative assets of $1 million is included in Prepaid expenses and other current assets, and the fair value amount of the derivative liabilities of $0.3 million is included in Accrued expenses and other current liabilities on our condensed consolidated balance sheets.

We recognized an unrealized gain of $1 million in Accumulated other comprehensive income (loss) for the effective portion of our derivative instruments during the three and six months ended July 31, 2015. The realized gains reclassified from Accumulated other comprehensive income (loss) to the related revenue line item in the condensed consolidated statements of operations were immaterial for the three and six months ended July 31, 2015.

During the three and six months ended July 31, 2015, all cash flow hedges were considered effective.

Foreign currency forward contracts not designated as hedges

We also enter into foreign currency forward contracts to hedge a portion of our net outstanding monetary assets and liabilities. These forward contracts are not designated as hedging instruments under applicable accounting guidance, and therefore all changes in the fair value of the forward contracts are recorded in Other expense, net in our condensed consolidated statements of operations. These forward contracts are intended to offset the foreign currency gains or losses associated with the underlying monetary assets and liabilities.

As of July 31, 2015 and January 31, 2015, we had outstanding forward contracts with total notional values of $9 million and $10 million, respectively. All contracts have terms of less than 60 days to maturity. The fair value amount of the derivative assets and derivative liabilities was less than $0.1 million, respectively, as of July 31, 2015. The fair value amount of the derivative assets was $0.4 million and the derivative liabilities was less than $0.1 million as of January 31, 2015. These assets and liabilities are included in Prepaid expenses and other current assets and in Accrued expenses and other current liabilities, respectively, on our condensed consolidated balance sheets.

We recognized a loss of less than $0.1 million and a gain of less than $0.1 million during the three and six months ended July 31, 2015, respectively, on derivative instruments not designated as hedging instruments. We recognized a net gain of less than $0.1 million during the three months and six months ended July 31, 2014 on derivative instruments not designated as hedging instruments. Gains or losses on derivative instruments not designated as hedging instruments are recorded within Other expense, net, in our condensed consolidated statements of operations.

Our foreign currency contracts are classified within Level 2 because the valuation inputs are based on quoted prices and market observable data of similar instruments in active markets, such as currency spot and forward rates.

Note 8. Convertible Senior Notes, Net

Convertible Senior Notes

In June 2013, we issued 0.75% convertible senior notes due July 15, 2018 (2018 Notes) with a principal amount of $350 million. The 2018 Notes are unsecured, unsubordinated obligations, and interest is payable in cash in arrears at a fixed rate of 0.75% on January 15 and July 15 of each year. The 2018 Notes mature on July 15, 2018 unless repurchased or converted in accordance with their terms prior to such date. We cannot redeem the 2018 Notes prior to maturity.

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Concurrently, we issued 1.50% convertible senior notes due July 15, 2020 (2020 Notes) with a principal amount of $250 million (together with the 2018 Notes, referred to as Notes). The 2020 Notes are unsecured, unsubordinated obligations, and interest is payable in cash in arrears at a fixed rate of 1.50% on January 15 and July 15 of each year. The 2020 Notes mature on July 15, 2020 unless repurchased or converted in accordance with their terms prior to such date. We cannot redeem the 2020 Notes prior to maturity.

The terms of the Notes are governed by Indentures by and between us and Wells Fargo Bank, National Association, as Trustee (the Indentures). Upon conversion, holders of the Notes will receive cash, shares of Class A common stock or a combination of cash and shares of Class A common stock, at our election.

For the 2018 Notes, the initial conversion rate is 12.0075 shares of Class A common stock per $1,000 principal amount, which is equal to an initial conversion price of approximately $83.28 per share of Class A common stock, subject to adjustment. Prior to the close of business on March 14, 2018, the conversion is subject to the satisfaction of certain conditions as described below. For the 2020 Notes, the initial conversion rate is 12.2340 shares of Class A common stock per $1,000 principal amount, which is equal to an initial conversion price of approximately $81.74 per share of Class A common stock, subject to adjustment. Prior to the close of business on March 13, 2020, the conversion is subject to the satisfaction of certain conditions, as described below.

Holders of the Notes who convert their Notes in connection with certain corporate events that constitute a make-whole fundamental change (as defined in the Indentures) 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 (as defined in the Indentures), holders of the Notes may require us to repurchase all or a portion of their Notes at a price equal to 100% of the principal amount of the Notes, plus any accrued and unpaid interest.

Holders of the 2018 Notes and 2020 Notes may convert all or a portion of their Notes prior to the close of business on March 14, 2018 for the 2018 Notes and March 13, 2020 for the 2020 Notes, in multiples of $1,000 principal amount, only under the following circumstances, none of which have occurred to date:

- if the last reported sale price of Class A common stock for at least twenty trading days during a period of thirty 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 of the respective Notes on each applicable trading day;
- during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of the respective Notes for each day of that five day consecutive trading day period was less than 98% of the product of the last reported sale price of Class A common stock and the conversion rate of the respective Notes on such trading day; or
- upon the occurrence of specified corporate events, as noted in the Indentures.

In accounting for the issuance of the Notes, we separated each of the Notes into liability and equity components. The carrying amounts of the liability components were calculated by measuring the fair value of similar liabilities that do not have associated convertible features. The carrying amount of the equity components representing the conversion option was determined by deducting the fair value of the liability components from the par value of the respective Notes. These differences represent debt discounts that are amortized to interest expense over the respective terms of the Notes. The equity components are not remeasured as long as they continue to meet the conditions for equity classification.

We allocated the total issuance costs incurred to the 2018 Notes and 2020 Notes on a prorated basis using the aggregate principal balances. In accounting for the issuance costs related to the 2018 Notes and 2020 Notes, we allocated the total amount of issuance costs incurred to liability and equity components. Issuance costs attributable to the liability components are being amortized to interest expense over the respective terms of the Notes, and the issuance costs attributable to the equity components were netted against the respective equity components in additional paid-in capital. For the 2018 Notes, we recorded liability issuance costs of $7 million and equity issuance costs of $2 million. Amortization expense for the liability issuance costs was $0.4 million for each of the three month periods ended July 31, 2015 and 2014, and $0.7 million for each of the six month periods ended July 31, 2015 and 2014. For the 2020 Notes, we recorded liability issuance costs of $5 million and equity issuance costs of $2 million. Amortization expense for the liability issuance costs was $0.2 million for each of the three month periods ended July 31, 2015 and 2014, and $0.3 million for each of the six month periods ended July 31, 2015 and 2014.

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The Notes, net consisted of the following (in thousands):

	July 31, 2015		January 31, 2015	
	2018 Notes	2020 Notes	2018 Notes	2020 Notes
Principal amounts:				
Principal	$350,000	$250,000	$350,000	$250,000
Unamortized debt discount[1]	(47,461)	(50,494)	(54,724)	(54,775)
Net carrying amount	$302,539	$199,506	$295,276	$195,225
Carrying amount of the equity component[2]	$74,892	$66,007	$74,892	$66,007

(1) Included in the condensed consolidated balance sheets within Convertible senior notes, net and amortized over the remaining lives of the Notes on the straight-line basis as it approximates the effective interest rate method.

(2) Included in the condensed consolidated balance sheets within Additional paid-in capital, net of $2 million and $2 million for the 2018 Notes and 2020 Notes, respectively, in equity issuance costs.

As of July 31, 2015, the remaining life of the 2018 Notes and 2020 Notes is approximately 35 months and 59 months, respectively.

The effective interest rates of the liability components of the 2018 Notes and 2020 Notes are 5.75% and 6.25%, respectively. These interest rates were based on the interest rates of similar liabilities at the time of issuance that did not have associated convertible features. The following table sets forth total interest expense recognized related to the 2018 Notes and 2020 Notes (in thousands):

	Three Months Ended July 31,				Six Months Ended July 31,			
	2015		2014		2015		2014	
	2018 Notes	2020 Notes	2018 Notes	2020 Notes	2018 Notes	2020 Notes	2018 Notes	2020 Notes
Contractual interest expense	$657	$937	$657	$937	$1,313	$1,875	$1,313	$1,875
Interest cost related to amortization of debt issuance costs	352	169	352	169	704	337	704	337
Interest cost related to amortization of the debt discount	3,658	2,157	3,454	2,027	7,264	4,281	6,859	4,022

Notes Hedges

In connection with the issuance of the 2018 Notes and 2020 Notes, we entered into convertible note hedge transactions with respect to our Class A common stock (Purchased Options). The Purchased Options cover, subject to anti-dilution adjustments substantially identical to those in the Notes, approximately 7.3 million shares of our Class A common stock and are exercisable upon conversion of the Notes. The Purchased Options have initial exercise prices that correspond to the initial conversion prices of the 2018 Notes and 2020 Notes, subject to anti-dilution adjustments substantially similar to those in the Notes. The Purchased Options will expire in 2018 for the 2018 Notes and in 2020 for the 2020 Notes, if not earlier exercised. The Purchased Options are intended to offset potential economic dilution to our Class A common stock upon any conversion of the Notes. The Purchased Options are separate transactions and are not part of the terms of the Notes.

We paid an aggregate amount of $144 million for the Purchased Options, which is included in Additional paid-in capital in the condensed consolidated balance sheets.

Warrants

In connection with the issuance of the Notes, we also entered into warrant transactions to sell warrants (the Warrants) to acquire, subject to anti-dilution adjustments, up to approximately 4.2 million shares in July 2018 and 3.1 million shares in July 2020 of our Class A common stock at an exercise price of $107.96 per share. If the Warrants are not exercised on their exercise dates, they will expire. If the market value per share of our Class A common stock exceeds the applicable exercise price of the Warrants, the Warrants will have a dilutive effect on our earnings per share

assuming that we are profitable. The Warrants are separate transactions, and are not part of the terms of the Notes or the Purchased Options.

We received aggregate proceeds of $93 million from the sale of the Warrants, which is recorded in Additional paid-in capital in the condensed consolidated balance sheets.

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Note 9. Commitments and Contingencies

Leases

We lease office space under non-cancelable operating leases in the U.S. and other countries with various expiration dates. Certain of our office leases are with an affiliate of our Chairman, David Duffield, who is also a significant stockholder (see Note 14).

The facility lease agreements generally provide for rental payments on a graduated basis and for options to renew, which could increase future minimum lease payments if exercised. We recognize rent expense on a straight-line basis over the period in which we benefit from the lease and have accrued for rent expense incurred but not paid. Rent expense totaled $7 million and $5 million for the three months ended July 31, 2015 and 2014, respectively, and $13 million and $9 million for the six months ended July 31, 2015 and 2014, respectively.

In January 2014, we entered into a 95-year lease for a 6.9-acre parcel of vacant land in Pleasanton, California, under which we paid $2 million for base rent from commencement through December 31, 2020. Annual rent payments of $0.2 million plus increases based on increases in the consumer price index begin on January 1, 2021 and continue through the end of the lease. If construction does not commence by December 31, 2015, we will be required to make additional payments to the lessor, ranging from $0.2 million to $1 million based on the length of the delay.

Legal Matters

We are a party to various legal proceedings and claims which arise in the ordinary course of business. In our opinion, there was not at least a reasonable possibility that we had incurred a material loss, or a material loss in excess of a recorded accrual, with respect to such loss contingencies.

Note 10. Common Stock and Stockholders' Equity

Common Stock

As of July 31, 2015, there were 111 million shares of Class A common stock and 81 million shares of Class B common stock outstanding. The rights of the holders of Class A common stock and Class B common stock are identical, except with respect to voting and conversion. Each share of Class A common stock is entitled to one vote per share and each share of Class B common stock is entitled to ten votes per share. Each share of Class B common stock can be converted into a share of Class A common stock at any time at the option of the holder.

Employee Equity Plans

Our 2012 Equity Incentive Plan (EIP) serves as the successor to our 2005 Stock Plan (together with the EIP, the Stock Plans). Pursuant to the terms of the EIP, the share reserve increased by 9 million shares on March 25, 2015, and as of July 31, 2015, we had approximately 57 million shares of Class A common stock available for future grants.

We also have a 2012 Employee Stock Purchase Plan (ESPP). Under the ESPP, eligible employees are granted options to purchase shares at the lower of 85% of the fair market value of the stock at the time of grant or 85% of the fair market value at the time of exercise. Options to purchase shares are granted twice yearly on or about June 1 and December 1 and exercisable on or about the succeeding November 30 and May 31, respectively, of each year. Pursuant to the terms of the ESPP, the share reserve increased by 2 million shares on March 25, 2015. On May 29, 2015, 0.2 million shares of Class A common shares were purchased under the ESPP at a weighted-average price of $67.08 per share, resulting in cash proceeds of $17 million. As of July 31, 2015, 5 million shares of Class A common stock were available for issuance under the ESPP.

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Stock Options

The Stock Plans provide for the issuance of incentive and nonstatutory options to employees and non-employees. We have also issued nonstatutory options outside of the Stock Plans. Options issued under the Stock Plans generally are exercisable for periods not to exceed 10 years and generally vest over five years. A summary of information related to stock option activity during the six months ended July 31, 2015 is as follows (in millions, except share and per share data):

	Outstanding Stock Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Balance as of January 31, 2015	16,663,557	$4.06	$1,256
Stock option grants	—	—	
Stock options exercised	(1,927,417)	3.22	
Stock options canceled	(113,883)	9.51	
Balance as of July 31, 2015	14,622,257	$4.13	$1,173
Vested and expected to vest as of July 31, 2015	14,445,622	$4.08	$1,159
Exercisable as of July 31, 2015	12,253,357	$3.36	$992

As of July 31, 2015, there was a total of $27 million in unrecognized compensation cost related to unvested stock options which is expected to be recognized over a weighted-average period of approximately 1.7 years.

Common Stock Subject to Repurchase

The Stock Plans allow for the early exercise of stock options for certain individuals as determined by the board of directors. We have the right to purchase at the original exercise price any unvested (but issued) common shares during the repurchase period following termination of services of an employee. The consideration received for an exercise of an option is considered to be a deposit of the exercise price and the related dollar amount is recorded as a liability. The shares and liabilities are reclassified into equity as the awards vest. As of both July 31, 2015 and January 31, 2015, we had $4 million recorded in liabilities related to early exercises of stock options.

Restricted Stock Awards

The Stock Plans provide for the issuance of restricted stock awards to employees. Restricted stock awards generally vest over five years. Under the EIP, 1 million restricted awards of Class B common stock are outstanding with weighted average grant date fair value of $12.93, all of which are subject to forfeiture as of July 31, 2015. During the three months ended July 31, 2015, 0.1 million shares of restricted stock awards vested with weighted average grant date fair value of $12.73.

As of July 31, 2015, there was a total of $8 million in unrecognized compensation cost related to unvested restricted stock awards, which is expected to be recognized over a weighted-average period of approximately 2.3 years.

Restricted Stock Units

The Stock Plans provide for the issuance of restricted stock units ("RSUs") to employees. RSUs generally vest over four years. A summary of information related to RSU activity during the six months ended July 31, 2015 is as follows:

	Number of Shares	Weighted-Average Grant Date Fair Value
Balance as of January 31, 2015	6,409,132	$ 76.93
RSUs granted	4,330,223	87.21
RSUs vested	(1,017,060)	78.02
RSUs forfeited	(259,170)	80.66
Balance as of July 31, 2015	9,463,125	$ 81.42

As of July 31, 2015, there was a total of $676 million in unrecognized compensation cost related to unvested RSUs, which is expected to be recognized over a weighted-average period of approximately 3.1 years.

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Performance-based Restricted Stock Awards

As of July 31, 2015. there are 0.1 million shares of performance-based restricted stock units (PRSUs) outstanding which were granted to all employees and include performance conditions related to company-wide goals and service conditions. We expect to grant additional shares related to this program for employees hired in fiscal 2016. These PRSU awards will vest if the performance conditions are achieved for the fiscal year ended January 31, 2016 and if the individual employee continues to provide service through the vesting date of March 15, 2016.

As of July 31, 2015, there was a total of $8 million in unrecognized compensation cost related to these performance-based restricted stock units, which will be recognized over a weighted-average period of approximately 8 months.

Note 11. Other Expense, Net

Other expense, net consisted of the following (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Interest income	$998	$669	$1,953	$1,364
Interest expense [1]	(7,952)	(7,765)	(15,837)	(15,473)
Gain from sale of cost method investment	3,220	—	3,220	—
Other income (expense)	(45)	143	(351)	157
Other expense, net	$(3,779)	$(6,953)	$(11,015)	$(13,952)

(1) Interest expense includes the contractual interest expense related to the 2018 Notes and 2020 Notes and non-cash interest related to amortization of the debt discount and debt issuance costs (See Note 8).

Note 12. Income Taxes

We compute the year-to-date income tax provision by applying the estimated annual effective tax rate to the year-to-date pre-tax income or loss and adjust for discrete tax items in the period. We reported a tax benefit of $1 million for the six months ended July 31, 2015, and a tax provision of $1 million for the six months ended July 31,2014. The income tax benefit for the six months ended July 31, 2015 consisted of:

- $2 million provision primarily resulting from income tax expense in profitable foreign jurisdictions and U.S. income tax expense on estimated taxable income before considering the realization of excess tax benefits from stock based compensation;
- $3 million tax benefit from the release of an acquired uncertain tax position including interest and penalties due to the lapse of statute of limitations.

The tax expense of $1 million for the six months ended July 31, 2014 was primarily attributable to the income tax expense in profitable foreign jurisdictions.

We are subject to income tax audits in the U.S. and foreign jurisdictions. We record liabilities related to uncertain tax positions. We believe that we have provided adequate reserves for income tax uncertainties in all open tax years. Due to our history of tax losses, all years remain open to tax audit.

On July 27, 2015, the United States Tax Court issued a taxpayer-favorable opinion with respect to Altera’s litigation with the Internal Revenue Service (“IRS”). The litigation relates to the treatment of share-based compensation expense in an inter-company cost-sharing arrangement with the taxpayer’s foreign subsidiary for fiscal years 2004 through 2007. In its opinion, the Court accepted Altera’s position of excluding share-based compensation in its cost sharing arrangement and concluded that the related IRS Regulations were invalid. The Court has yet to issue its decision, the timing of which is uncertain. Once the Court’s decision is issued, the IRS has 90 days to decide whether to appeal the Court’s decision.

We are monitoring this case and its potential favorable implications to the Company’s cost-sharing arrangement. We currently estimate that this court case will not have a material impact to our effective tax rate and income tax expense due to our current full valuation allowance position.

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Note 13. Net Loss Per Share

Basic net loss per share attributable to common stockholders is computed by dividing the net loss attributable to common stockholders 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 our outstanding stock options, outstanding warrants, common stock related to unvested early exercised stock options, common stock related to unvested restricted stock awards and convertible senior notes to the extent dilutive, and common stock issuable pursuant to the ESPP. Basic and diluted net loss per share was the same for each period presented, as the inclusion of all potential common shares outstanding would have been anti-dilutive.

The net loss per share attributable to common stockholders is allocated based on the contractual participation rights of the Class A common shares and Class B common shares as if the loss for the year had been distributed. As the liquidation and dividend rights are identical, the net loss attributable to common stockholders is allocated on a proportionate basis.

We consider shares issued upon the early exercise of options subject to repurchase and unvested restricted stock awards to be participating securities because holders of such shares have non-forfeitable dividend rights in the event of our declaration of a dividend for common shares. In future periods, to the extent we are profitable, we will subtract earnings allocated to these participating securities from net income to determine net income attributable to common stockholders.

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

	Three Months Ended July 31,				Six Months Ended July 31,			
	2015		2014		2015		2014	
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Net loss per share, basic and diluted:								
Numerator:								
Allocation of distributed net loss	$(40,382)	$(29,039)	$(36,528)	$(32,687)	$(75,376)	$(55,603)	$(66,916)	$(61,688)
Denominator:								
Weighted-average common shares outstanding	110,150	79,210	97,275	87,044	108,411	79,971	95,602	88,131
Basic and diluted net loss per share	$(0.37)	$(0.37)	$(0.38)	$(0.38)	$(0.70)	$(0.70)	$(0.70)	$(0.70)

The anti-dilutive securities excluded from the weighted-average shares used to calculate the diluted net loss per common share were as follows (in thousands):

	As of July 31,	
	2015	2014
Outstanding common stock options	14,622	18,577
Shares subject to repurchase	892	1,435
Unvested restricted stock awards, units, and PRSUs	10,227	7,411
Shares related to the convertible senior notes	7,261	7,261
Shares subject to warrants related to the issuance of convertible senior notes	7,261	7,261
Shares issuable pursuant to the ESPP	264	257
	40,527	42,202

Note 14. Related-Party Transactions

We currently lease certain office space from an affiliate of our Chairman, Mr. Duffield, adjacent to our corporate headquarters in Pleasanton, California under various lease agreements. The term of the agreements is 10 years and the total rent due under the agreements is $6 million for the fiscal year ended January 31, 2016, and $65 million in total.

Rent expense under these agreements was $2 million and $1 million for the three months ended July 31, 2015 and 2014, and $3 million and $2 million for the six months ended July 31, 2015 and 2014, respectively.

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Note 15. Geographic Information

Revenue by geography is generally based on the address of the customer as defined in our master subscription agreement. The following tables set forth revenue by geographic area (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
United States	$237,058	$156,288	$447,339	$288,817
International	45,638	30,492	86,314	57,700
Total	$282,696	$186,780	$533,653	$346,517

No single country other than the United States had revenues greater than 10% of total revenues for the three and six months ended July 31, 2015 and 2014. No customer individually accounted for more than 10% of our accounts receivable, net as of July 31, 2015 or January 31, 2015.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements. All statements contained in this report other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans, and our objectives for future operations, are forward-looking statements. The words “believe,” “may,” “will,” “estimate,” “continue,” “anticipate,” “intend,” “expect,” “seek,” “strive,” and similar expressions are intended to identif forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in the “Risk Factors” section. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this report may not occur and actual results could differ materially and adversely from those anticipated or implied by the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. The events and circumstances reflected in the forward-looking statements may not be achieved or occur. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. We are under no duty to update any of these forward-looking statements after the date of this report or to conform these statements to actual results or revised expectations.

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

You should read the following discussion of our financial condition and results of operations in conjunction with the condensed consolidated financial statements and notes thereto included elsewhere in this report. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this report, as well as in the section entitled “Risk Factors.”

Overview

Workday provides financial management, human capital management, and analytics applications designed for the world's largest companies, educational institutions, and government agencies. We offer innovative and adaptable technology focused on the consumer Internet experience and cloud delivery model. Our applications are designed for global enterprises to manage complex and dynamic operating environments. We provide our customers highly adaptable, accessible and reliable applications to manage critical business functions that enable them to optimize their financial and human capital resources.

We were founded in 2005 to deliver cloud applications to global enterprises. Our applications are designed around the way people work today – in an environment that is global, collaborative, fast-paced and mobile. Our cycle of frequent updates has facilitated rapid innovation and the introduction of new applications throughout our history. We began offering our Human Capital Management (HCM) application in 2006. Since then we have continued to invest in innovation and have consistently introduced new services to our customers, including our Financial Management application in 2007, our Procurement and Employee Expense Management applications in 2008, our Payroll and mobile applications in 2009, our Talent Management application in 2010, our native iPad application and Workday integration platform in 2011, our Time Tracking and Grants Management applications in 2012, Recruiting in 2014, and Insight Applications and Professional Services Automation in 2015.

We offer Workday applications to our customers on an enterprise-wide subscription basis, typically with three-year terms and with subscription fees largely based on the size of the customer’s workforce. We generally recognize revenues from subscription fees ratably over the term of the contract. We currently derive a substantial majority of our subscription services revenues from subscriptions to our HCM application. We market our applications through our direct sales force.

We have achieved significant growth in a relatively short period of time. Our diverse customer base includes large, global companies and our direct sales force generally targets organizations with more than 1,000 workers. A substantial majority of our growth comes from new customers. Our current financial focus is on growing our revenues and expanding our customer base. While we are incurring losses today, we strive to invest in a disciplined manner across all of our functional areas to sustain continued near-term revenue growth and support our long-term initiatives. Our operating expenses have increased significantly in absolute dollars in recent periods, primarily due to the significant growth of our employee population. We had approximately 4,500 and approximately 3,150 employees as of July 31, 2015 and 2014, respectively.

We intend to continue investing for long-term growth. We have invested, and expect to continue to invest, heavily in our application development efforts to deliver additional compelling applications and to address customers’ evolving needs. In addition, we plan to continue to expand our ability to sell our applications globally, particularly in Europe and Asia, through investments in product development and customer support to address the business needs of local markets, increasing our sales and marketing organizations, adding new offices, and expanding our ecosystem of services partners to support local deployments. We expect to make further significant investments in our data center infrastructure in fiscal 2016 as we plan for future growth. We are also investing in personnel to service our growing customer base. These investments will increase our costs on an absolute basis in the near-term. Many of these investments will occur in advance of experiencing any direct benefit from them and will make it difficult to determine if we are allocating our resources efficiently. We expect our product development, sales and marketing, and general and administrative expenses as a percentage of total revenues to decrease over time as we grow our revenues, and we anticipate that we will gain economies of scale by increasing our customer base without direct incremental

development costs and by utilizing more of the capacity of our data centers.

Since inception, we have invested heavily in our professional services organization to help ensure that customers successfully deploy and adopt our applications. Additionally, we continue to expand our professional services partner ecosystem to further support our customers. We believe our investment in professional services, as well as partners building consulting practices around Workday, will drive additional customer subscriptions and continued growth in revenues. In addition, over time we expect professional services revenues and the cost of professional services as a percentage of total revenues will decline as we increasingly rely on our partners to deploy Workday applications and as the number of our existing customers continues to grow.

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Components of Results of Operations

Revenues

We primarily derive our revenues from subscription services fees and professional services fees. Subscription services revenues primarily consist of fees that give our customers access to our cloud applications, which include routine customer support at no additional cost. Professional services fees include deployment services, optimization services, and training.

Subscription services revenues accounted for 79% of our total revenues during the three months ended July 31, 2015 and represented 97% of our total unearned revenue as of July 31, 2015. Subscription services revenues are driven primarily by the number of customers, the number of workers at each customer, the number of applications subscribed to by each customer, and the price of our applications.

The mix of the applications to which a customer subscribes can affect our financial performance due to price differentials in our applications. Compared to our other offerings, our HCM application has been available for a longer period of time, is more established in the marketplace and has benefited from continued enhancements of the functionality over a longer period of time, all of which help us to improve our pricing for that application. However, new products or services offerings by competitors in the future could impact the mix and pricing of our offerings.

Subscription services fees are recognized ratably as revenues over the contract term beginning on the date the application is made available to the customer, which is generally within one week of contract signing. Our subscription contracts typically have a term of three years and are non-cancelable. We generally invoice our customers in advance, in annual installments. Amounts that have been invoiced are initially recorded as unearned revenue. Amounts that have not yet been invoiced represent backlog and are not reflected in our condensed consolidated financial statements.

The majority of our consulting engagements are billed on a time and materials basis, and revenues are typically recognized as the services are performed. We offer a number of training options intended to support our customers in configuring, using and administering our services. In some cases, we supplement our consulting teams by subcontracting resources from our service partners and deploying them on customer engagements. As Workday's professional services organization and the Workday-related consulting practices of our partner firms continue to develop, we expect the partners to increasingly contract directly with our subscription customers. As a result of this trend, and the increase of our subscription services revenues, we expect professional services revenues as a percentage of total revenues to decline over time.

Costs and Expenses

Costs of subscription services revenues. Costs of subscription services revenues consist primarily of employee-related expenses related to hosting our applications and providing customer support, the costs of data center capacity, and depreciation of computer equipment and software.

Costs of professional services revenues. Costs of professional services revenues consist primarily of employee-related expenses associated with these services, the cost of subcontractors and travel.

Product development. Product development expenses consist primarily of employee-related costs. We continue to focus our product development efforts on adding new features and applications, increasing the functionality and enhancing the ease of use of our cloud applications.

Sales and marketing. Sales and marketing expenses consist primarily of employee-related costs, sales commissions, marketing programs and travel. Marketing programs consist of advertising, events, corporate communications, brand building and product marketing activities. Commissions earned by our sales force that can be associated specifically with a non-cancelable subscription contract are generally deferred and amortized over the same period that revenues are recognized for the related non-cancelable contract.

General and administrative. General and administrative expenses consist of employee-related costs for finance and accounting, legal, human resources and management information systems personnel, legal costs, professional fees and other corporate expenses.

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Results of Operations

Revenues

Our total revenues for the three and six months ended July 31, 2015 and 2014 were as follows:

	Three Months Ended July 31,			Six Months Ended July 31,		
	2015	2014	% Change	2015	2014	% Change
	(in thousands, except percentages)					
Revenues:						
Subscription services	$223,742	$143,652	56%	$424,735	$267,059	59%
Professional services	58,954	43,128	37%	108,918	79,458	37%
Total revenues	$282,696	$186,780	51%	$533,653	$346,517	54%

Total revenues were $283 million for the three months ended July 31, 2015, compared to $187 million during the prior year period, an increase of $96 million, or 51%. Subscription services revenues were $224 million for the three months ended July 31, 2015, compared to $144 million for the prior year period, an increase of $80 million, or 56%. The increase in subscription services revenues was due primarily to the recognition of revenue for an increased number of customer contracts as compared to the prior year period. Professional services revenues were $59 million for the three months ended July 31, 2015, compared to $43 million for the prior year period, an increase of $16 million, or 37%. The increase in professional services revenues was due primarily to the addition of new customers and a greater number of customers requesting deployment and integration services.

Total revenues were $534 million for the six months ended July 31, 2015, compared to $347 million during the prior year period, an increase of $187 million, or 54%. Subscription services revenues were $425 million for the six months ended July 31, 2015, compared to $267 million for the prior year period, an increase of $158 million, or 59%. The increase in subscription services revenues was due primarily to the recognition of revenue for an increased number of customer contracts as compared to the prior year period. Professional services revenues were $109 million for the six months ended July 31, 2015, compared to $79 million for the prior year period, an increase of $30 million, or 37%. The increase in professional services revenues was due primarily to the addition of new customers and a greater number of customers requesting deployment and integration services.

Core Operating Expenses

We use the non-GAAP financial measure of core operating expenses to understand and compare operating results across accounting periods, for internal budgeting and forecasting purposes, for short- and long-term operating plans, and to evaluate our financial performance and the ability of operations to generate cash. We believe that core operating expenses reflects our ongoing business in a manner that allows for meaningful period-to-period comparisons and analysis of trends in our business, as it excludes expenses that are not reflective of ongoing operating results. We also believe that core operating expenses provide useful information to investors and others in understanding and evaluating our operating results and future prospects in the same manner as management and in comparing financial results across accounting periods and to those of peer companies.

The following discussion of our core operating expenses and the components of our core operating expenses highlights the factors that we focus upon in evaluating our operating margin and operating expenses. The increases or decreases in operating expenses discussed in this section do not include changes relating to share-based compensation expenses, and certain other expenses, which consist of employer payroll tax-related items on employee stock transactions and amortization of acquisition-related intangible assets.

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Reconciliation of our core operating expenses to the nearest GAAP measure, total operating expenses, is as follows:

	Three Months Ended July 31, 2015			
	Core Operating Expenses[1]	Share-Based Compensation Expenses	Other Operating Expenses	Total Operating Expenses
	(in thousands, except percentages)			
Costs of subscription services	$32,038	$3,173	$76	$35,287
Costs of professional services	51,478	5,144	170	56,792
Product development	85,645	28,632	1,068	115,345
Sales and marketing	92,881	13,222	327	106,430
General and administrative	21,373	14,593	516	36,482
Total costs and expenses	$283,415	$64,764	$2,157	$350,336
Operating loss	$(719)	$(64,764)	$(2,157)	$(67,640)
Operating margin	—%	(23)%	(1)%	(24)%

	Three Months Ended July 31, 2014			
	Core Operating Expenses[1]	Share-Based Compensation Expenses	Other Operating Expenses	Total Operating Expenses
	(in thousands, except percentages)			
Costs of subscription services	$22,723	$1,608	$42	$24,373
Costs of professional services	37,702	3,519	46	$41,267
Product development	59,939	16,737	788	$77,464
Sales and marketing	70,908	7,377	238	$78,523
General and administrative	14,614	11,541	767	$26,922
Total costs and expenses	$205,886	$40,782	$1,881	$248,549
Operating loss	$(19,106)	$(40,782)	$(1,881)	$(61,769)
Operating margin	(10)%	(22)%	(1)%	(33)%

	Six Months Ended July 31, 2015			
	Core Operating Expenses[1]	Share-Based Compensation Expenses	Other Operating Expenses	Total Operating Expenses
	(in thousands, except percentages)			
Costs of subscription services	$61,586	$5,221	$262	$67,069
Costs of professional services	93,802	8,598	524	102,924
Product development	161,856	49,443	3,381	214,680
Sales and marketing	178,780	21,587	958	201,325
General and administrative	40,407	27,189	1,103	68,699
Total costs and expenses	$536,431	$112,038	$6,228	$654,697
Operating loss	$(2,778)	$(112,038)	$(6,228)	$(121,044)
Operating margin	(1)%	(21)%	(1)%	(23)%

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	Six Months Ended July 31, 2014			
	Core Operating Expenses[1]	Share-Based Compensation Expenses	Other Operating Expenses	Total Operating Expenses
	(in thousands, except percentages)			
Costs of subscription services	$43,081	$2,663	$88	$45,832
Costs of professional services	71,375	5,717	135	77,227
Product development	113,560	27,605	1,470	142,635
Sales and marketing	132,050	14,129	511	146,690
General and administrative	28,085	19,542	358	47,985
Total costs and expenses	$388,151	$69,656	$2,562	$460,369
Operating loss	$(41,634)	$(69,656)	$(2,562)	$(113,852)
Operating margin	(12)%	(20)%	(1)%	(33)%

[1] See “Non-GAAP Financial Measures” below for further information.

Core operating margins

Core operating margins, calculated using GAAP revenues and core operating expenses, improved from (10)% for the three months ended July 31, 2014 to (0.3)% for the three months ended July 31, 2015, and from (12)% for the six months ended July 31, 2014 to (0.5)% for the six months ended July 31, 2015. The improvements in our core operating margins in the three and six months ended July 31, 2015 were primarily due to higher subscription services revenues, higher professional services revenues and improvements in operating leverage.

In evaluating our results, we generally focus on core operating expenses. We believe that our core operating expenses reflect our ongoing business in a manner that allows meaningful period-to-period comparisons. Our core operating expenses are reconciled to the most comparable GAAP measure, “total operating expenses,” in the table above.

Core operating expenses increased by $78 million, or 38% and $148 million, or 38% for the three and six months ended July 31, 2015, respectively, compared to the prior year periods. The increases were primarily due to higher employee-related costs driven by higher headcount.

Costs of subscription services

Core operating expenses in costs of subscription services were $32 million for the three months ended July 31, 2015, compared to $23 million for the prior year period, an increase of $9 million, or 39%. The increase was primarily due to an increase of $3 million in employee-related costs driven by higher headcount, an increase of $3 million in depreciation expense related to our data centers, an increase of $1 million in facilities and IT expenses and an increase of $1 million in service contracts expense to expand data center capacity.

Core operating expenses in costs of subscription services were $62 million for the six months ended July 31, 2015, compared to $43 million for the prior year period, an increase of $19 million, or 44%. The increase was primarily due to an increase of $6 million in employee-related costs driven by higher headcount, an increase of $6 million in depreciation expense related to our data centers, an increase of $3 million in facilities and IT expenses and an increase of $2 million in service contracts expense to expand data center capacity.

We expect that core operating expenses in costs of subscription services will continue to increase in absolute dollars as we improve and expand our data center capacity and operations.

Costs of professional services

Core operating expenses in costs of professional services were $51 million for the three months ended July 31, 2015, compared to $38 million for the prior year period, an increase of $13 million, or 34%. This increase was primarily due to increases of $8 million to staff our deployment and integration engagements and $1 million in facility and IT-related expenses.

Core operating expenses in costs of professional services were $94 million for the six months ended July 31, 2015, compared to $71 million for the prior year period, an increase of $23 million, or 32%. This increase was primarily due to increases of $17 million to staff our deployment and integration engagements and $3 million in facility and IT-related expenses.

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Over time, we expect costs of professional services as a percentage of total revenues to continue to decline as we increasingly rely on third parties to deploy our applications and as the number of our customers continues to grow. For fiscal 2016, we anticipate professional services margins to be lower than fiscal 2015 as we invest in building our partnership ecosystem in new market segments and geographies.

Product development

Core operating expenses in product development were $86 million for the three months ended July 31, 2015, compared to $60 million for the prior year period, an increase of $26 million, or 43%. The increase was primarily due to increases of $18 million in employee-related costs driven by higher headcount and $5 million in facility and IT-related expenses.

Core operating expenses in product development were $162 million for the six months ended July 31, 2015, compared to $114 million for the prior year period, an increase of $48 million, or 42%. The increase was primarily due to increases of $34 million in employee-related costs driven by higher headcount and $9 million in facility and IT-related expenses.

We expect that product development expenses will continue to increase in absolute dollars as we improve and extend our applications and develop new technologies.

Sales and marketing

Core operating expenses in sales and marketing were $93 million for the three months ended July 31, 2015, compared to $71 million for the prior year period, an increase of $22 million, or 31%. The increase was primarily due to increases of $13 million in employee-related costs driven by higher headcount and higher commissionable sales volume, $4 million in advertising, marketing and event costs and $3 million in facility and IT-related expenses.

Core operating expenses in sales and marketing were $179 million for the six months ended July 31, 2015, compared to $132 million for the prior year period, an increase of $47 million, or 36%. The increase was primarily due to increases of $27 million in employee-related costs driven by higher headcount and higher commissionable sales volume, $10 million in advertising, marketing and event costs, $5 million in facility and IT-related expenses and $3 million in travel expenses.

We expect that sales and marketing expenses will continue to increase in absolute dollars as we continue to invest in the expansion of our domestic and international selling and marketing activities to build brand awareness and attract new customers.

General and administrative

Core operating expenses in general and administrative were $21 million for the three months ended July 31, 2015, compared to $15 million for the prior year period, an increase of $6 million, or 40%. The increase was primarily due to $3 million in higher employee-related costs driven by higher headcount and $3 million in higher consulting fees.

Core operating expenses in general and administrative were $40 million for the six months ended July 31, 2015, compared to the $28 million for the prior year period, an increase of $12 million, or 43%. The increase was primarily due to $7 million in higher employee-related costs driven by higher headcount and $5 million in higher professional fees.

We expect general and administrative expenses will continue to increase in absolute dollars as we further invest in our infrastructure and support our international expansion.

Share-Based Compensation Expenses

Share-based compensation expenses were $65 million and $112 million for the three and six months ended July 31, 2015, respectively, compared to $41 million and $70 million for the prior year periods, respectively. The increase in share-based compensation expenses was primarily due to grants of RSUs to existing and new employees during the six months ended July 31, 2015. During the three and six months ended July 31, 2015, the realized excess tax benefits related to share-based compensation were immaterial.

Other Operating Expenses

Other operating expenses include employer payroll tax-related items on employee stock transactions of $2 million and $6 million for the three and six months ended July 31, 2015, respectively, and $2 million for each of the respective prior year periods. In addition, other operating expenses included amortization of acquisition-related intangible assets of $0.4 million and $0.7 million for the three and six months ended July 31, 2015, respectively, and $0.3 million and

$0.5 million for the three and six months ended July 31, 2014, respectively.

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Other Expense, Net

Other expense, net, decreased $3 million for the three and six months ended July 31, 2015 as compared to the respective prior year periods. The decrease is primarily due to the gain on sale of a cost method investment in the current quarter of $3 million. The contractual cash interest expense related to the 2018 and 2020 Notes was $2 million and $3 million for the three and six months ended July 31, 2015, respectively, and $2 million and $3 million for the three and six months ended July 31, 2014, respectively. The non-cash interest expense related to amortization of the debt discount and amortization of debt issuance costs with respect to the 2018 and 2020 Notes was $6 million and $12 million for the three and six months ended July 31, 2015, respectively, and $6 million and $12 million for the three and six months ended July 31, 2014, respectively.

Liquidity and Capital Resources

As of July 31, 2015, our principal sources of liquidity were cash, cash equivalents and marketable securities totaling $1.9 billion, which were held for working capital purposes. Our cash equivalents and marketable securities are comprised primarily of U.S. agency obligations, U.S. treasury securities, U.S. corporate securities, commercial paper, and money market funds.

We have financed our operations primarily through sales of equity securities, customer payments, and issuance of debt. Our future capital requirements will depend on many factors, including our customer growth rate, subscription renewal activity, the timing and extent of development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced services offerings, the continuing market acceptance of our services, the possible construction on the leased land in Pleasanton, California and acquisition activities. We may enter into arrangements to acquire or invest in complementary businesses, services, technologies or intellectual property rights in the future. We also may choose to seek additional equity or debt financing.

Our cash flows for the three and six months ended July 31, 2015 and 2014 were as follows:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
	(in thousands)			
Net cash provided by (used in):				
Operating activities	$15,511	$(9,011)	$109,570	$12,686
Investing activities	(73,725)	18,192	(198,073)	(334,174)
Financing activities	18,518	7,467	21,051	2,772
Effect of exchange rate changes	(210)	(15)	(162)	24
Net increase (decrease) in cash and cash equivalents	$(39,906)	$16,633	$(67,614)	$(318,692)

In evaluating our performance internally, we focus on long-term, sustainable growth in free cash flows. We define free cash flows, a non-GAAP financial measure, as net cash provided by (used in) operating activities minus purchases of property and equipment, property and equipment acquired under capital leases and purchases of other (non-acquisition-related) intangible assets. See “Non-GAAP Financial Measures” below for further information.

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
	(in thousands)			
Net cash provided by (used in) operating activities	$15,511	$(9,011)	$109,570	$12,686
Purchases of property and equipment	(25,792)	(28,409)	(55,972)	(38,282)
Free cash flows	$(10,281)	$(37,420)	$53,598	$(25,596)

	Trailing Twelve Months Ended July 31,	
	2015	2014
	(in thousands)	
Net cash provided by (used in) operating activities	$198,887	$54,555

Purchases of property and equipment	(121,336)	(67,380)
Purchases of other intangible assets	—	(15,000)
Free cash flows	$77,551	$(27,825)

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Operating Activities

We use net cash provided by operating activities as a key financial metric. Cash provided by operating activities was $16 million for the three months ended July 31, 2015, and cash used in operating activities was $9 million for the three months ended July 31, 2014. The improvement in cash flow provided by operating activities was primarily due to increased cash collections driven by growth in our customer sales contracts, partially offset by increases in our headcount and other operational expenses.

Net cash provided by operating activities was $110 million and $13 million for the six months ended July 31, 2015 and 2014, respectively. The improvement in cash flow was primarily due to increased cash collections driven by growth in our customer sales contracts, partially offset by increases in our headcount and other operational expenses.

Investing Activities

Cash used in investing activities for the three months ended July 31, 2015 was $74 million, which was primarily the result of the timing of purchases and maturities of marketable securities, capital expenditures of $26 million, purchases of cost method investments of $16 million, and a net cash outflow of $8 million related to an acquisition in May 2015. These payments were partially offset by proceeds of $20 million from the sale of available-for-sale securities, and proceeds of $4 million from the sale of a cost method investment. We expect capital expenditures will be approximately $150 million for the year ending January 31, 2016. We expect that these capital outlays will largely be used to expand the infrastructure of our data centers and to build out additional office space to support our growth. We acquired a leasehold interest in land in Pleasanton, California in January 31, 2014. We are actively evaluating construction alternatives for this site and therefore have not yet factored any related development costs into our expected capital expenditures described above.

Cash provided by investing activities for the three months ended July 31, 2014 was $18 million, which was primarily the result of the timing of purchases and maturities of marketable securities and the $8 million proceeds from the sale of one available-for-sale security, partially offset by capital expenditures of $28 million and a $10 million cost method investment.

Cash used in investing activities for the six months ended July 31, 2015 was $198 million, which was primarily the result of the timing of purchases and maturities of marketable securities, capital expenditures of $56 million, purchases of cost method investments of $16 million, and a net cash outflow of $8 million related to an acquisition. These payments were partially offset by proceeds of $30 million from the sale of available-for-sale securities, and proceeds of $4 million from the sale of a cost method investment.

Cash used in investing activities for the six months ended July 31, 2014 was $334 million, which was primarily the result of the timing of purchases and maturities of marketable securities, capital expenditures of $38 million and a $10 million cost method investment. These payments were partially offset by proceeds of $8 million from the sale of available-for-sale securities.

Financing Activities

For the three months ended July 31, 2015, cash provided by financing activities was $19 million, which was primarily due to $19 million of proceeds from the issuance of common stock from employee equity plans, partially offset by $1 million in principal payments on our capital lease obligations.

For the three months ended July 31, 2014, cash provided by financing activities was $7 million, which was primarily due to $15 million of proceeds from the issuance of common stock from employee equity plans, partially offset by $3 million of Class A common share repurchases for tax withholdings on vesting of restricted stock and $4 million in principal payments on our capital lease obligations.

For the six months ended July 31, 2015, cash provided by financing activities was $21 million, which was primarily due to $23 million of proceeds from the issuance of common stock from employee equity plans, partially offset by $2 million in principal payments on our capital lease obligations.

For the six months ended July 31, 2014, cash provided by financing activities was $3 million, which was primarily due to $18 million of proceeds from the issuance of common stock from employee equity plans, partially offset by $8 million of Class A common share repurchases for tax withholdings on vesting of restricted stock and $7 million in principal payments on our capital lease obligations.

Free Cash Flows

In addition to net cash provided by (used in) operating activities, management uses free cash flows as a key financial metric. Free cash flows improved by $27 million to $(10) million for the three months ended July 31, 2015, compared to $(37) million for the prior year period. The improvement was primarily due to increased sales and the related cash collections and decreased capital expenditures resulting from $19 million of property and equipment acquired but not paid for as of July 31, 2015, partially offset by higher operating expenses, driven primarily by increased headcount.

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Free cash flows increased by $80 million to $54 million for the six months ended July 31, 2015, compared to $(26) million for the prior year period. The improvement was primarily due to increased sales and the related cash collections, partially offset by increased capital expenditures and higher operating expenses, driven primarily by increased headcount.

Non-GAAP Financial Measures

Regulation S-K Item 10(e), "Use of non-GAAP financial measures in Commission filings," defines and prescribes the conditions for use of non-GAAP financial information. Our measures of core operating expenses, core operating margin and free cash flows each meet the definition of a non-GAAP financial measure.

Core Operating Expenses

We define core operating expenses as our total operating expenses excluding the following components, which we believe are not reflective of our ongoing operational expenses. In each case, for the reasons set forth below, management believes that excluding the component provides useful information to investors and others in understanding and evaluating our operating results and future prospects in the same manner as management, in comparing financial results across accounting periods and to those of peer companies and to better understand the long-term performance of our core business.

- Share-Based Compensation Expenses. Although share-based compensation is an important aspect of the compensation of our employees and executives, management believes it is useful to exclude share-based compensation in order to better understand the long-term performance of our core business and to facilitate comparison of our results to those of peer companies. For restricted stock unit awards, the amount of share-based compensation expenses is not reflective of the value ultimately received by the grant recipients. Moreover, determining the fair value of certain of the share-based instruments we utilize involves a high degree of judgment and estimation and the expense recorded may bear little resemblance to the actual value realized upon the vesting or future exercise of the related share-based awards. Unlike cash compensation, the value of stock options and shares offered under the ESPP, which are elements of our ongoing share-based compensation expenses, is determined using a complex formula that incorporates factors, such as market volatility and forfeiture rates, that are beyond our control.
- Other Operating Expenses. Other operating expenses include employer payroll tax-related items on employee stock transactions and amortization of acquisition-related intangible assets. The amount of employer payroll tax-related items on share-based compensation is dependent on our stock price and other factors that are beyond our control and do not correlate to the operation of the business. For business combinations, we generally allocate a portion of the purchase price to intangible assets. The amount of the allocation is based on estimates and assumptions made by management and is subject to amortization. The amount of purchase price allocated to intangible assets and the term of its related amortization can vary significantly and are unique to each acquisition and thus we do not believe it is reflective of our ongoing operations.

Free Cash Flows

We define free cash flows as net cash provided by (used in) operating activities minus purchases of property and equipment, property and equipment acquired under capital leases and purchases of other (non-acquisition-related) intangible assets. We use free cash flows as a measure of financial progress in our business, as it balances operating results, cash management and capital efficiency. When calculating free cash flows, we subtract the gross value of all equipment paid for or acquired under capital leases, so that we can evaluate our progress on free cash flows independent of our capital financing decisions. We believe information regarding free cash flows provides investors and others with an important perspective on the cash available to make strategic acquisitions and investments, to fund ongoing operations and to fund other capital expenditures.

Limitations on the Use of Non-GAAP Financial Measures

A limitation of our non-GAAP financial measures of core operating expenses, core operating margin and free cash flows is that they do not have uniform definitions. Our definitions will likely differ from the definitions used by other companies, including peer companies, and therefore comparability may be limited. Thus, our non-GAAP measures of core operating expenses, core operating margin and free cash flows should be considered in addition to, not as a substitute for, or in isolation from, measures prepared in accordance with GAAP. Additionally, in the case of share-based compensation, if we did not pay out a portion of compensation in the form of share-based compensation

and related employer payroll tax-related items, the cash salary expense included in costs of revenues and operating expenses would be higher, which would affect our cash position. Further, the non-GAAP measure of core operating expenses has certain limitations because it does not reflect all items of expense that affect our operations and are reflected in the GAAP measure of total operating expenses.

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We compensate for these limitations by reconciling core operating expenses to the most comparable GAAP financial measure and reviewing these measures in conjunction with GAAP financial information. We encourage investors and others to review our financial information in its entirety, not to rely on any single financial measure and to view our non-GAAP financial measures in conjunction with the most comparable GAAP financial measures.

See "Results of Operations—Core Operating Expenses" for a reconciliation of the non-GAAP financial measure of core operating expenses to the most comparable GAAP measure, "total operating expenses," for the three and six months ended July 31, 2015 and 2014.

See "Liquidity and Capital Resources" for a reconciliation of free cash flows to the most comparable GAAP measure, "Net cash provided by (used in) operating activities," for the three and six months ended July 31, 2015 and 2014.

Commitments

Our principal commitments primarily consist of obligations under leases for office space and co-location facilities for data center capacity and our development and test data center, as well as computer equipment. As of July 31, 2015, the future non-cancelable minimum payments under operating leases were $198 million. During the remainder of the year ended January 31, 2016, we anticipate leasing additional office space near our headquarters and in various other locations around the world to support our growth. In addition, our existing lease agreements often provide us with an option to renew. We expect our future operating lease obligations will increase as we expand our operations.

In January 2014, we entered into a 95-year lease for a 6.9-acre parcel of vacant land in Pleasanton, California, under which we paid $2 million for base rent from commencement through December 31, 2020. Annual rent payments of $0.2 million plus increases based on increases in the consumer price index begin on January 1, 2021 and continue through the end of the lease. If construction does not commence by December 31, 2015, we will be required to make additional payments to the lessor, ranging from $0.2 million to $1 million based on the length of the delay.

We are not required to make principal payments under the Notes prior to maturity. If the Notes are not converted to Class A common stock prior to their maturity dates, we are required to repay $350 million in principal on July 15, 2018 and $250 million in principal on July 15, 2020. We are also required to make interest payments on a semi-annual basis at the interest rates described in Note 8 of the notes to the condensed consolidated financial statements.

We do not consider outstanding purchase orders to be purchase commitments as they represent authorizations to purchase rather than binding agreements.

Off-Balance Sheet Arrangements

Through July 31, 2015, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

During the six months ended July 31, 2015, there were no significant changes to our critical accounting policies and estimates as described in financial statements contained in the Annual Report on Form 10-K for the year ended January 31, 2015 filed with the Securities and Exchange Commission (SEC) on March 25, 2015.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Risk

We transact business globally in multiple currencies. As a result, our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. Our most significant currency exposures are the Euro and British Pound Sterling. Due to the relative size of our international operations to date and the fact that the majority of our international contracts are currently in U.S. dollars, our foreign currency exposure has been fairly limited. We anticipate that our exposure to foreign currency fluctuations will increase over time, and, as a result, we initiated a hedging program focused on certain currencies in fiscal 2015.

Interest Rate Sensitivity

We had cash, cash equivalents and marketable securities totaling $1.9 billion as of July 31, 2015. Cash equivalents and marketable securities were invested primarily in U.S. agency obligations, U.S. treasury securities, corporate securities, commercial paper, and money market funds. The cash, cash equivalents and marketable securities are held for working capital purposes. Our investments are made for capital preservation purposes. We do not enter into investments for trading or speculative purposes.

Our cash equivalents and our portfolio of marketable securities are subject to market risk due to changes in interest rates. Fixed rate securities may have their market value adversely affected due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fluctuate due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. However, because we classify our marketable securities as “available for sale,” no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary.

An immediate increase of 100-basis points in interest rates would have resulted in a $7 million market value reduction in our investment portfolio as of July 31, 2015. All of our investments earn less than 100-basis points and as a result, an immediate decrease of 100-basis points in interest rates would have increased the market value by $2 million as of July 31, 2015. This estimate is based on a sensitivity model that measures market value changes when changes in interest rates occur. Fluctuations in the value of our investment securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities.

Market Risk and Market Interest Risk

In June 2013, we issued $350 million of 2018 Notes and $250 million of 2020 Notes. Holders may convert the Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, holders of the 2018 Notes and 2020 Notes will receive cash, shares of Class A common stock or a combination of cash and shares of Class A common stock, at our election.

Concurrently with the issuance of the Notes, we entered into separate note hedge and warrant transactions. These separate transactions were completed to reduce the potential economic dilution from the conversion of the Notes.

Our Notes have fixed annual interest rates at 0.75% and 1.50% and, therefore, we do not have economic interest rate exposure on our Notes. However, the values of the Notes are exposed to interest rate risk. Generally, the fair market value of our fixed interest rate Notes will increase as interest rates fall and decrease as interest rates rise. In addition, the fair values of the 2018 Notes and the 2020 Notes are affected by our stock price. The carrying values of our 2018 Notes and 2020 Notes were $303 million and $200 million, respectively, as of July 31, 2015. These represent the liability component of the principal balance of our Notes as of July 31, 2015. The total estimated fair values of the 2018 Notes and 2020 Notes at July 31, 2015 were $418 million and $310 million, respectively, and the fair value was determined based on the quoted bid price of the Notes in an over-the-counter market as of the last day of trading for the three months ended at July 31, 2015, which were $119.31 and $124.19, respectively. For further information, see Note 8 of the notes to condensed consolidated financial statements.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act), as of the end of the period covered by this report (Evaluation Date).

In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management’s evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are designed to, and are effective to, provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

(b) Changes in Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recently completed fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there has not been any material change in our internal control over financial reporting during the quarter covered by this report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of business, we are involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, employment and other claims. We have been, and may in the future be, put on notice and/or sued by third parties for alleged infringement of their proprietary rights, including patent infringement. We evaluate these claims and lawsuits with respect to their potential merits, our potential defenses and counterclaims, and the expected effect on us. Our technologies may be subject to injunction if they are found to infringe the rights of a third party. In addition, many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which could increase the cost to us of an adverse ruling on such a claim.

The outcome of any litigation, regardless of its merits, is inherently uncertain. Any intellectual property claims and other lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention from executing our business plan, lead to attempts on the part of other parties to seek similar claims and, in the case of intellectual property claims, require us to change our technology, change our business practices and/or pay monetary damages or enter into short- or long-term royalty or licensing agreements. In general, the resolution of a legal matter could prevent us from offering our services to others, could be material to our financial condition or cash flows, or both, or could otherwise adversely affect our operating results.

We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. In management’s opinion, resolution of these matters is not expected to have a material adverse impact on our condensed consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, of a particular quarter.

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ITEM 1A. RISK FACTORS

Investing in our securities involves a high degree of risk. You should consider carefully the risks and uncertainties described below, together with all of the other information in this report, including the condensed consolidated financial statements and the related notes included elsewhere in this report, before making an investment decision. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that materially and adversely affect our business. If any of the following risks actually occurs, our business operations, financial condition, results of operations, and prospects could be materially and adversely affected. The market price of our securities could decline due to the materialization of these or any other risks, and you could lose part or all of your investment.

Risk Factors Related to Our Business

If our security measures are breached or unauthorized access to customer data is otherwise obtained, our applications may be perceived as not being secure, customers may reduce the use of or stop using our applications and we may incur significant liabilities.

Our applications involve the storage and transmission of our customers' proprietary information, including personal or identifying information regarding their employees, customers and suppliers, as well as their finance and payroll data. As a result, unauthorized or excessive access or security breaches could result in the loss of information, litigation, indemnity obligations and other liabilities. While we have security measures in place designed to protect customer information and prevent data loss and other security breaches, if these measures are breached as a result of third-party action, employee error, malfeasance or otherwise, and someone obtains unauthorized access to our customers' data, our reputation could be damaged, our business may suffer and we could incur significant liabilities. Because the techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any or all of these issues could negatively affect our ability to attract new customers, cause existing customers to elect to terminate or not renew their subscriptions, result in reputational damage, cause us to issue refunds or service credits to customers for prepaid and unused subscription services, or result in lawsuits, regulatory fines or other action or liabilities, which could adversely affect our operating results.

We depend on data centers and computing infrastructure operated by third parties and any disruption in these operations could adversely affect our business.

We host our applications and serve all of our customers from data centers located in Ashburn, Virginia; Lithia Springs, Georgia; Portland, Oregon; Dublin, Ireland; and Amsterdam, the Netherlands. While we control and have access to our servers and all of the components of our network that are located in our external data centers, we do not control the operation of these facilities. The owners of our data center facilities have no obligation to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew these agreements on commercially reasonable terms, or if one of our data center operators is acquired, we may be required to transfer our servers and other infrastructure to new data center facilities, and we may incur significant costs and possible service interruption in connection with doing so.

In addition, we rely upon Amazon Web Services (AWS), which provides a distributed computing infrastructure platform for business operations, to operate certain aspects of our services, such as environments for development testing, training and sales demonstrations. Given this, along with the fact that we cannot easily switch our AWS operations to another cloud provider, any disruption of or interference with our use of AWS would impact our operations and our business could be adversely impacted.

Problems faced by our third-party data center operations, with the telecommunications network providers with whom we or they contract, or with the systems by which our telecommunications providers allocate capacity among their customers, including us, or problems faced by AWS, could adversely affect the experience of our customers. Our third-party data center operators could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy, faced by our third-party data center operators or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict. Additionally, if our data centers or AWS are unable to keep up with our needs for capacity, this could have

an adverse effect on our business. Any changes in third-party service levels at our data centers or at AWS or any errors, defects, disruptions, or other performance problems with our applications could adversely affect our reputation and may damage our customers' stored files or result in lengthy interruptions in our services. Interruptions in our services might adversely affect our reputation and operating results, cause us to issue refunds or service credits to customers for prepaid and unused subscription services, subject us to potential liabilities, result in contract terminations, or adversely affect our renewal rates.

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Furthermore, our financial management application is essential to our customers' financial projections, reporting and compliance programs, particularly customers who are public reporting companies. Any interruption in our service may affect the availability, accuracy or timeliness of these and as a result could damage our reputation, cause our customers to terminate their use of our applications, require us to indemnify our customers against certain losses and prevent us from gaining additional business from current or future customers.

If we fail to manage our technical operations infrastructure, or experience service outages or delays in the deployment of our applications, we may be subject to liabilities and our reputation and operating results may be adversely affected.

We have experienced significant growth in the number of users, transactions and data that our operations infrastructure supports. We seek to maintain sufficient excess capacity in our operations infrastructure to meet the needs of all of our customers. We also seek to maintain excess capacity to facilitate the rapid provision of new customer deployments and the expansion of existing customer deployments. In addition, we need to properly manage our technological operations infrastructure in order to support version control, changes in hardware and software parameters, the evolution of our applications and to reduce infrastructure latency associated with dispersed geographic locations. However, the provision of new hosting infrastructure requires significant lead time. If we do not accurately predict our infrastructure requirements, our existing customers may experience service outages. If our operations infrastructure fails to scale, customers may experience delays as we seek to obtain additional capacity.

We have experienced, and may in the future experience, system disruptions, outages and other performance problems. These problems may be caused by a variety of factors, including infrastructure changes, human or software errors, viruses, security attacks (internal and external), fraud, spikes in customer usage and denial of service issues. In some instances, we may not be able to identify the cause or causes of these performance problems within an acceptable period of time. Our customer agreements typically provide service level commitments on a monthly basis. If we are unable to meet the stated service level commitments or suffer extended periods of unavailability for our applications, we may be contractually obligated to issue refunds or service credits to customers for prepaid and unused subscription services, or we could face contract terminations. Any extended service outages could result in customer losses, and adversely affect our reputation, revenues and operating results.

Catastrophic events may disrupt our business.

Our corporate headquarters are located in Pleasanton, California and we have data centers located in Ashburn, Virginia; Lithia Springs, Georgia; Portland, Oregon; Sacramento, California; Dublin, Ireland; and Amsterdam, the Netherlands. We also rely on AWS's distributed computing infrastructure platform. The west coast of the United States contains active earthquake zones and the southeast is subject to seasonal hurricanes. Additionally, we rely on our network and third-party infrastructure and enterprise applications, internal technology systems and our website for our development, marketing, operational support, hosted services and sales activities. In the event of a major earthquake, hurricane or catastrophic event such as fire, power loss, telecommunications failure, cyber-attack, war or terrorist attack, we may be unable to continue our operations and may endure system interruptions, reputational harm, delays in our application development, lengthy interruptions in our services, breaches of data security and loss of critical data, all of which could have an adverse effect on our operating results.

Privacy concerns and laws or other domestic or foreign regulations may reduce the effectiveness of our applications and adversely affect our business.

Our customers can use our applications to collect, use and store personal or identifying information regarding their employees, customers and suppliers. National and local governments and agencies in the countries in which our customers operate have adopted, are considering adopting, or may adopt laws and regulations regarding the collection, use, storage and disclosure of personal information obtained from consumers and individuals. These laws are particularly stringent in Europe. If Workday employees fail to adhere to adequate data protection practices around the usage of our customer's personal data, it may damage our reputation and brand. In addition, the affected customers or government authorities could initiate legal or regulatory action against us in connection with such incidents, which could result in significant fines, penalties and liabilities.

The costs of compliance with, and other burdens imposed by, privacy laws and regulations that are applicable to the businesses of our customers may adversely affect our customers' ability and willingness to process, handle, store, use

and transmit demographic and personal information of their employees, customers and suppliers, which could limit the use, effectiveness and adoption of our applications and reduce overall demand. Even the perception of privacy concerns, whether or not valid, may inhibit market adoption, effectiveness or use of our applications.

In addition to government activity, privacy advocacy groups and the technology and other industries are considering various new, additional or different self-regulatory standards that may place additional burdens on us. If the processing of personal information were to be curtailed in this manner, our software applications would be less effective, which may reduce demand for our applications and adversely affect our business.

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We have experienced rapid growth. If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of service and operational controls or adequately address competitive challenges.
We have experienced, and are continuing to experience, a period of rapid growth in our customers, headcount and operations. In particular, we grew from approximately 300 employees as of December 31, 2008 to approximately 4,500 employees as of July 31, 2015, and have also significantly increased the size of our customer base. We anticipate that we will significantly expand our operations and headcount in the near term, and will continue to expand our customer base. This growth has placed, and future growth will place, a significant strain on our management, general and administrative resources and operational infrastructure. Our success will depend in part on our ability to manage this growth effectively and to scale our operations. To manage the expected growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. As we continue to grow, we also need to ensure that our policies and procedures evolve to reflect our current operations and are appropriately communicated to and observed by employees, and that we appropriately manage our corporate information assets, including confidential and proprietary information. Failure to effectively manage growth could result in difficulty or delays in deploying customers, declines in quality or customer satisfaction, increases in costs, difficulties in introducing new features or other operational difficulties, and any of these difficulties could adversely impact our business performance and results of operations.
We depend on our senior management team and the loss of one or more key employees could adversely affect our business.
Our success depends largely upon the continued services of our executive officers. We also rely on our leadership team in the areas of product development, marketing, sales, services and general and administrative functions, and on mission-critical individual contributors in product development. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. We do not have employment agreements with our executive officers or other key personnel that require them to continue to work for us for any specified period and they could terminate their employment with us at any time. The loss of one or more of our executive officers or key employees and any failure to develop an appropriate succession plan for these persons could have a serious adverse effect on our business.
An inability to attract and retain highly skilled employees could adversely affect our business and our future growth prospects.
To execute our growth plan, we must attract and retain highly qualified personnel, and our managers must be successful in hiring employees who are a good cultural fit and have the competencies to succeed at Workday. Competition for these personnel is intense, especially for engineers with high levels of experience in designing and developing software and Internet-related services and senior sales executives. From time to time, we have experienced, and we expect to continue to experience, difficulty in hiring and retaining employees with appropriate qualifications, and may not be able to fill positions in desired geographic areas or at all.
Many of the companies with which we compete for experienced personnel have greater resources than we have and some of these companies may offer greater compensation packages. Particularly in the San Francisco Bay Area, job candidates and existing employees carefully consider the value of the stock awards they receive in connection with their employment. If the perceived value of our stock awards declines, or if the mix of equity and cash compensation that we offer is unattractive, it may adversely affect our ability to recruit and retain highly skilled employees. Job candidates may also be threatened with legal action by their existing employers if we hire them, which could have a chilling effect on hiring and result in a diversion of our time and resources. We must also continue to retain and motivate existing employees through our compensation practices, company culture and career development opportunities. If we fail to attract new personnel or to retain our current personnel, our business and future growth prospects could be adversely affected.
If we cannot maintain our corporate culture, we could lose the innovation, teamwork and passion that we believe contribute to our success, and our business may be harmed.
We believe that a critical component of our success has been our corporate culture, as reflected in our core values: employees, customer service, innovation, integrity and fun. We have invested substantial time and resources in building our team. As we continue to grow and develop the infrastructure associated with being a public company, we

will need to maintain our corporate culture among a larger number of employees. Any failure to preserve our culture could negatively affect our future success, including our ability to retain and recruit personnel and to effectively focus on and pursue our corporate objectives.

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The markets in which we participate are intensely competitive, and if we do not compete effectively, our operating results could be adversely affected.

The markets for financial management and HCM applications are highly competitive, with relatively low barriers to entry for some applications or services. Our primary competitors are SAP and Oracle, well-established providers of financial management and HCM applications, which have long-standing relationships with many customers. Some customers may be hesitant to switch vendors or to adopt cloud applications such as ours, and prefer to maintain their existing relationships with competitors. SAP and Oracle are larger and have greater name recognition, much longer operating histories, larger marketing budgets and significantly greater resources than we do. These vendors, as well as other competitors, could offer financial management and HCM applications on a standalone basis at a low price or bundled as part of a larger product sale. In order to take advantage of customer demand for cloud applications, legacy vendors are expanding their cloud applications through acquisitions, strategic alliances and organic development. Legacy vendors may also seek to partner with other leading cloud providers, such as the alliance between Oracle and Salesforce.com. We also face competition from custom-built software vendors and from vendors of specific applications, some of which offer cloud-based solutions. These vendors include, without limitation: The Ultimate Software Group, Inc., Automatic Data Processing and Infor Global Solutions. We also face competition from cloud-based vendors including providers of applications for HCM and payroll services such as Ceridian; providers of cloud-based expense management applications such as Concur Technologies, Inc. (which was acquired by SAP); and providers of financial management applications such as NetSuite, Inc. We may also face competition from a variety of vendors of cloud-based and on-premise software applications that address only a portion of one of our applications. In addition, other companies that provide cloud applications in different target markets may develop applications or acquire companies that operate in our target markets, and some potential customers may elect to develop their own internal applications. With the introduction of new technologies and market entrants, we expect this competition to intensify in the future.

Many of our competitors are able to devote greater resources to the development, promotion and sale of their products and services. Furthermore, our current or potential competitors may be acquired by third parties with greater available resources and the ability to initiate or withstand substantial price competition. In addition, many of our competitors have established marketing relationships, access to larger customer bases and major distribution agreements with consultants, system integrators and resellers. Our competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their product offerings or resources. If our competitors' products, services or technologies become more accepted than our applications, if they are successful in bringing their products or services to market earlier than ours, or if their products or services are more technologically capable than ours, then our revenues could be adversely affected. In addition, some of our competitors may offer their products and services at a lower price. If we are unable to achieve our target pricing levels, our operating results would be negatively affected. Pricing pressures and increased competition could result in reduced sales, reduced margins, losses or a failure to maintain or improve our competitive market position, any of which could adversely affect our business.

If the market for enterprise cloud computing grows more slowly than in recent years, our business could be adversely affected.

The enterprise cloud computing market is not as mature as the market for on-premise enterprise software. Our success will depend to a substantial extent on the continued growth of cloud computing in general, and of financial management and HCM services in particular. Many enterprises have invested substantial personnel and financial resources to integrate traditional enterprise software into their businesses, and therefore may be reluctant or unwilling to migrate to cloud computing. It is difficult to predict customer adoption rates and demand for our applications, the future growth rate and size of the cloud computing market or the entry of competitive applications. The continued expansion of the cloud computing market depends on a number of factors, including the cost, performance, and perceived value associated with cloud computing, as well as the ability of cloud computing companies to address security and privacy concerns. Further, the cloud computing market is less developed in many jurisdictions outside of the United States. If we or other cloud computing providers experience security incidents, loss of customer data, disruptions in delivery or other problems, the market for cloud computing applications as a whole, including our applications, may be negatively affected. If there is a reduction in demand for cloud computing caused by a lack of

customer acceptance, technological challenges, weakening economic conditions, security or privacy concerns, competing technologies and products, decreases in corporate spending or otherwise, it could result in decreased revenues or growth rates and our business could be adversely affected.

To date, we have derived a substantial majority of our subscription services revenues from our HCM application. Our efforts to increase sales of our HCM application as well as our other applications may not succeed, and may reduce our revenue growth rate.

To date, we have derived a substantial majority of our subscription services revenues from our HCM application. Any factor adversely affecting sales of this application, including application release cycles, market acceptance, product competition, performance and reliability, reputation, price competition, and economic and market conditions, could adversely affect our business and operating results. Our participation in the markets for our financial management and analytics applications is more recent, and it is uncertain whether these areas will ever result in significant revenues for us. Further, the introduction of new applications beyond these markets may not be successful.

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If we are not able to provide successful enhancements, new features and modifications, our business could be adversely affected.

If we are unable to provide enhancements and new features for our existing applications or new applications that achieve market acceptance or that keep pace with rapid technological developments, our business could be adversely affected. For example, we are focused on enhancing the features and functionality of our applications to enhance their utility to larger customers with complex, dynamic and global operations. The success of enhancements, new features and applications depends on several factors, including the timely completion, introduction and market acceptance of the enhancements or new features or applications. Failure in this regard may significantly impair our revenue growth. In addition, because our applications are designed to operate on a variety of systems, we will need to continuously modify and enhance our applications to keep pace with changes in Internet-related hardware, iOS, Android and other mobile-related technologies and other software, communication, browser and database technologies. We may not be successful in either developing these modifications and enhancements or in bringing them to market in a timely fashion. We must also appropriately balance the product capability demands of our current customers with the capabilities required to address the broader market. Furthermore, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies, could increase our product development expenses. Any failure of our applications to operate effectively with future network platforms and technologies could reduce the demand for our applications, result in customer dissatisfaction and adversely affect our business.

Our applications must integrate with a variety of third-party technologies, and if we are unable to ensure that our solutions interoperate with such technologies, demand for our applications and our operating results could be adversely affected.

Our applications must integrate with a variety of technologies and we must continuously modify and enhance our applications to adapt to changes in operating systems, hardware, software, communication, browser and database technologies. Any failure of our solutions to operate effectively with future technologies or our failure to respond to changes in a timely and effective manner could reduce the demand for our applications, result in customer dissatisfaction and harm our operating results and business.

If our applications fail to perform properly, our reputation could be adversely affected, our market share could decline and we could be subject to liability claims.

Our applications are inherently complex and may contain material defects or errors. Any defects in functionality or that cause interruptions in the availability of our applications could result in:

- loss or delayed market acceptance and sales;
- breach of warranty claims;
- issue refunds or service credits to customers for prepaid and unused subscription services;
- loss of customers;
- diversion of development and customer service resources; and
- injury to our reputation.

The costs incurred in correcting any material defects or errors might be substantial and could adversely affect our operating results.

Because of the large amount of data that we collect and manage, it is possible that hardware failures or errors in our systems could result in data loss or corruption, or cause the information that we collect to be incomplete or contain inaccuracies that our customers regard as significant. Furthermore, the availability or performance of our applications could be adversely affected by a number of factors, including customers' inability to access the Internet, the failure of our network or software systems, security breaches or variability in user traffic for our services. We may be required to issue credits or refunds for prepaid amounts related to unused services or otherwise be liable to our customers for damages they may incur resulting from certain of these events. For example, our customers access our applications through their Internet service providers. If a service provider fails to provide sufficient capacity to support our applications or otherwise experiences service outages, such failure could interrupt our customers' access to our applications, which could adversely affect their perception of our applications' reliability and our revenues. In addition to potential liability, if we experience interruptions in the availability of our applications, our reputation could be

adversely affected and we could lose customers.

Our errors and omissions insurance may be inadequate or may not be available in the future on acceptable terms, or at all. In addition, our policy may not cover all claims made against us and defending a suit, regardless of its merit, could be costly and divert management's attention.

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Because we sell applications to manage complex operating environments of large customers, we encounter long sales cycles, which could adversely affect our operating results in a given period.

Our ability to increase revenues and achieve and maintain profitability depends, in large part, on widespread acceptance of our applications by large businesses and other organizations. As we target our sales efforts at these customers, we face greater costs, longer sales cycles and less predictability in completing some of our sales. In the large enterprise market, the customer's decision to use our applications may be an enterprise-wide decision and, therefore, these types of sales require us to provide greater levels of education regarding the use and benefits of our applications. In addition, our target customers may prefer to purchase applications that are critical to their business from one of our larger, more established competitors. Our typical sales cycles are six to twelve months, and we expect that this lengthy sales cycle may continue or increase as customers adopt our applications beyond HCM. Longer sales cycles could cause our operating and financial results to suffer in a given period.

Our customers' deployment timeframes vary based on many factors including the number and type of applications being deployed, the complexity and scale of the customers' businesses, the configuration requirements, the number of integrations with other systems and other factors, many of which are beyond our control.

The loss of one or more of our key customers, or a failure to renew our subscription agreements with one or more of our key customers, could negatively affect our ability to market our applications.

We rely on our reputation and recommendations from key customers in order to promote subscriptions to our applications. The loss of, or failure to renew by, any of our key customers could have a significant impact on our revenues, reputation and our ability to obtain new customers. In addition, acquisitions of our customers could lead to cancellation of our contracts with those customers or by the acquiring companies, thereby reducing the number of our existing and potential customers. Acquisitions of our partners could also result in a decrease in the number of our current and potential customers, as our partners may no longer facilitate the adoption of our applications.

Our business could be adversely affected if our customers are not satisfied with the deployment services provided by us or our partners.

Our business depends on our ability to satisfy our customers, both with respect to our application offerings and the professional services that are performed to help our customers use features and functions that address their business needs. Professional services may be performed by our own staff, by a third party, or by a combination of the two. Our strategy is to work with third parties to increase the breadth of capability and depth of capacity for delivery of these services to our customers, and third parties provide a majority of our deployment services. If customers are not satisfied with the quality of work performed by us or a third party or with the type of professional services or applications delivered, then we could incur additional costs to address the situation, the revenue profile of the contract could be impacted, and the dissatisfaction with our services could damage our ability to expand the applications subscribed to by our customers. We must also align our product development and professional services operations in order to ensure that customers' evolving needs are met. Negative publicity related to our customer relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new business with current and prospective customers.

Any failure to offer high-quality technical support services may adversely affect our relationships with our customers and our financial results.

Once our applications are deployed, our customers depend on our support organization to resolve technical issues relating to our applications. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services. We also may be unable to modify the format of our support services to compete with changes in support services provided by our competitors. Increased customer demand for these services, without corresponding revenues, could increase costs and adversely affect our operating results. In addition, our sales process is highly dependent on our applications and business reputation and on positive recommendations from our existing customers. Any failure to maintain high-quality technical support, or a market perception that we do not maintain high-quality support, could adversely affect our reputation, our ability to sell our applications to existing and prospective customers, and our business, operating results and financial position.

Sales to customers outside the United States or with international operations expose us to risks inherent in international sales and operations.

A key element of our growth strategy is to expand our international operations and develop a worldwide customer base. To date, we have not realized a substantial portion of our revenues from customers headquartered outside the United States. Operating in international markets requires significant resources and management attention and will subject us to regulatory, economic and political risks that are different from those in the United States. Because of our limited experience with international operations, our international expansion efforts may not be successful in creating demand for our applications outside of the United States or in effectively selling subscriptions to our applications in all of the international markets we enter. In addition, we will face risks in doing business internationally that could adversely affect our business, including:

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- the need to localize and adapt our applications for specific countries, including translation into foreign languages and associated expenses;
- the need for a go-to-market strategy that aligns product management efforts and the development of supporting infrastructure;
- data privacy laws which require that customer data be stored and processed in a designated territory;
- difficulties in appropriately staffing and managing foreign operations and providing appropriate compensation for local markets;
- difficulties in leveraging executive presence and company culture globally;
- different pricing environments, longer sales cycles and longer accounts receivable payment cycles and collections issues;
- new and different sources of competition;
- weaker protection for intellectual property and other legal rights than in the United States and practical difficulties in enforcing intellectual property and other rights outside of the United States;
- laws, customs and business practices favoring local competitors;
- compliance challenges related to the complexity of multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy and data protection laws and regulations;
- increased financial accounting and reporting burdens and complexities;
- restrictions on the transfer of funds;
- ensuring compliance with anti-corruption laws including the Foreign Corrupt Practices Act;
- the effects of currency fluctuations on our revenues and customer demand for our services;
- adverse tax consequences; and
- unstable economic and political conditions.

Some of our international contracts are not denominated in local currencies. However, the majority of our international costs are denominated in local currencies. We anticipate that over time, an increasing portion of our international contracts may be denominated in local currencies. Therefore, fluctuations in the value of the U.S. dollar and foreign currencies may impact our operating results when translated into U.S. dollars. We have a hedging program but we cannot assure that this hedging program will be effective and we will continue to have risk of exchange rate fluctuations.

We have acquired, and may in the future acquire, other companies, employee teams or technologies, which could divert our management's attention, result in additional dilution to our stockholders and otherwise disrupt our operations and adversely affect our operating results.

We have acquired, and may in the future acquire, other companies, employee teams or technologies to complement or expand our applications, enhance our technical capabilities, obtain personnel or otherwise offer growth opportunities. The pursuit of acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated.

We have limited experience in acquisitions. We may not be able to integrate acquired personnel, operations and technologies successfully or effectively manage the combined operations following the acquisition. We also may not achieve the anticipated benefits from the acquisitions due to a number of factors, including:

- inability to integrate or benefit from acquisitions in a profitable manner;
- incurrence of acquisition-related costs or liabilities, some of which may be unanticipated;
- difficulty integrating the intellectual property, operations and accounting systems of the acquired business;
- difficulty integrating and retaining the personnel of the acquired business;
- difficulties and additional expenses associated with supporting legacy products and hosting infrastructure of the acquired business;
- difficulty converting the customers of the acquired business onto our applications and contract terms, including disparities in the revenues, licensing, support or professional services model of the acquired company;
- diversion of management's attention from other business concerns;

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- adverse effects on our existing business relationships with business partners and customers as a result of the acquisition;
- use of resources that are needed in other parts of our business; and
- use of substantial portions of our available cash to consummate the acquisition.

In addition, a significant portion of the purchase price of companies we acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our operating results based on this impairment assessment process, which could adversely affect our results of operations.

Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial position may suffer.

We have a history of cumulative losses and we do not expect to be profitable for the foreseeable future.

We have incurred significant losses in each period since our inception in 2005. These losses and our accumulated deficit reflect the substantial investments we made to acquire new customers and develop our applications. We expect our operating expenses to increase in the future due to anticipated increases in sales and marketing expenses, product development expenses, operations costs and general and administrative costs, and therefore we expect our losses to continue for the foreseeable future. Furthermore, to the extent we are successful in increasing our customer base, we will also incur increased losses in the acquisition period because costs associated with acquiring customers are generally incurred up front, while subscription services revenues are generally recognized ratably over the terms of the agreements, which are typically three years. You should not consider our recent growth in revenues as indicative of our future performance. Accordingly, we cannot assure you that we will achieve profitability in the future, nor that, if we do become profitable, we will sustain profitability.

We may not receive significant revenues from our current development efforts for several years, if at all.

Developing software applications is expensive and the investment in product development often involves a long return on investment cycle. We have made and expect to continue to make significant investments in development and related product opportunities. Accelerated product introductions and short product life cycles require high levels of expenditures that could adversely affect our operating results if not offset by revenue increases. We believe that we must continue to dedicate a significant amount of resources to our development efforts to maintain our competitive position. However, we may not receive significant revenues from these investments for several years, if at all.

If we experience significant fluctuations in our rate of anticipated growth and fail to balance our expenses with our revenue forecasts, our results could be harmed.

Our ability to forecast our future rate of growth is limited and subject to a number of uncertainties, including general economic and market conditions. We plan our expense levels and investment on estimates of future revenue and future anticipated rates of growth. We may not be able to adjust our spending quickly enough if our growth rates fall short of our expectations.

Moreover, we have encountered and will encounter risks and uncertainties frequently experienced by growing companies in rapidly changing industries, such as the risks and uncertainties described herein. If our assumptions regarding these risks and uncertainties (which we use to plan our business) are incorrect or change due to changes in our markets, or if we do not address these risks successfully, our operating and financial results could differ materially from our expectations and our business could suffer.

We may not be able to sustain our revenue growth rates in the future.

You should not consider our historical revenue growth rates as indicative of our future performance. Our revenue growth rates have declined, and may decline in future periods, as the size of our customer base increases and as we achieve higher market penetration rates. Other factors may also contribute to declines in our growth rates, including slowing demand for our services, increasing competition, a decrease in the growth of our overall market, our failure to continue to capitalize on growth opportunities, and the maturation of our business, among others. As our growth rates decline, investors' perceptions of our business and the trading price of our securities could be adversely affected.

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Because we recognize subscription services revenues over the term of the contract, downturns or upturns in new sales will not be immediately reflected in our operating results and may be difficult to discern.

We generally recognize subscription services revenues from customers ratably over the terms of their contracts, which are typically three years. As a result, most of the subscription services revenues we report in each quarter are derived from the recognition of unearned revenue relating to subscriptions entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any single quarter will likely have a minor impact on our revenue results for that quarter. However, such a decline will negatively affect our revenues in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our applications, and potential changes in our pricing policies or rate of renewals, may not be fully reflected in our results of operations until future periods. We may be unable to adjust our cost structure to reflect the changes in revenues. In addition, a significant majority of our costs are expensed as incurred, while revenues are recognized over the life of the customer agreement. As a result, increased growth in the number of our customers could result in our recognition of more costs than revenues in the earlier periods of the terms of our agreements. Our subscription model also makes it difficult for us to rapidly increase our revenues through additional sales in any period, as revenues from new customers generally are recognized over the applicable subscription term.

Our quarterly results may fluctuate significantly and may not fully reflect the underlying performance of our business.

Our quarterly results of operations, including the levels of our revenues, gross margin, core operating margin, profitability, cash flow and unearned revenue, may vary significantly in the future and period-to-period comparisons of our operating results may not be meaningful. Accordingly, the results of any one quarter should not be relied upon as an indication of future performance. Our quarterly financial results may fluctuate as a result of a variety of factors, many of which are outside of our control, and as a result, may not fully reflect the underlying performance of our business. Fluctuation in quarterly results may negatively impact the value of our securities. Factors that may cause fluctuations in our quarterly financial results include, without limitation, those listed below:

- our ability to attract new customers;
- the addition or loss of large customers, including through acquisitions or consolidations;
- the timing of recognition of revenues;
- the amount and timing of operating expenses related to the maintenance and expansion of our business, operations and infrastructure;
- network outages or security breaches;
- general economic, industry and market conditions;
- customer renewal rates;
- increases or decreases in the number of elements of our services or pricing changes upon any renewals of customer agreements;
- changes in our pricing policies or those of our competitors;
- the mix of applications sold during a period;
- seasonal variations in sales of our applications, which have historically been highest in our fiscal fourth quarter;
- the timing and success of new application and service introductions by us or our competitors or any other change in the competitive dynamics of our industry, including consolidation among competitors, customers or strategic partners; and
- the timing of expenses related to the development or acquisition of technologies or businesses and potential future charges for impairment of goodwill from acquired companies.

Our ability to predict the rate of customer subscription renewals or adoptions, and the impact these renewals and adoptions will have on our revenues or operating results, is limited.

As the markets for our applications mature, or as new competitors introduce new products or services that compete with ours, we may be unable to attract new customers at the same price or based on the same pricing model as we have used historically. Moreover, large customers, which are the focus of our sales efforts, may demand greater price concessions. As a result, in the future we may be required to reduce our prices, which could adversely affect our revenues, gross margin, profitability, financial position and cash flow.

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In addition, our customers have no obligation to renew their subscriptions for our applications after the expiration of the initial subscription period. Our customers may renew for fewer elements of our applications or on different pricing terms. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our pricing or our applications and their ability to continue their operations and spending levels. If our customers do not renew their subscriptions for our applications on similar pricing terms, our revenues may decline and our business could suffer. In addition, over time the average term of our contracts could change based on renewal rates or for other reasons.

Our future success also depends in part on our ability to sell additional features or enhanced elements of our applications to our current customers. This may require increasingly costly sales efforts that are targeted at senior management. If these efforts are not successful, our business may suffer.

Failure to adequately expand our direct sales force will impede our growth.

We will need to continue to expand and optimize our sales infrastructure in order to grow our customer base and our business. We plan to continue to expand our direct sales force, both domestically and internationally. Identifying and recruiting qualified personnel and training them in the use of our software requires significant time, expense and attention. It can take nine months or longer before our sales representatives are fully trained and productive. Our business may be adversely affected if our efforts to expand and train our direct sales force do not generate a corresponding increase in revenues. In particular, if we are unable to hire, develop and retain talented sales personnel or if new direct sales personnel are unable to achieve desired productivity levels in a reasonable period of time, we may not be able to realize the expected benefits of this investment or increase our revenues.

If we fail to develop widespread brand awareness cost-effectively, our business may suffer.

We believe that developing and maintaining widespread awareness of our brand in a cost-effective manner is critical to achieving widespread acceptance of our applications and attracting new customers. Brand promotion activities may not generate customer awareness or increase revenues, and even if they do, any increase in revenues may not offset the expenses we incur in building our brand. If we fail to successfully promote and maintain our brand, or incur substantial expenses, we may fail to attract or retain customers necessary to realize a sufficient return on our brand-building efforts, or to achieve the widespread brand awareness that is critical for broad customer adoption of our applications.

Our growth depends in part on the success of our strategic relationships with third parties.

In order to grow our business, we anticipate that we will continue to depend on relationships with third parties, such as deployment partners, and technology and content providers. Identifying partners, and negotiating and documenting relationships with them, requires significant time and resources. Our competitors may be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our services. In addition, acquisitions of our partners by our competitors could result in a decrease in the number of our current and potential customers, as our partners may no longer facilitate the adoption of our applications by potential customers. If we are unsuccessful in establishing or maintaining our relationships with third parties, our ability to compete in the marketplace or to grow our revenues could be impaired and our operating results may suffer. Even if we are successful, we cannot assure you that these relationships will result in increased customer usage of our applications or increased revenues.

Adverse economic conditions may negatively impact our business.

Our business depends on the overall demand for enterprise software and on the economic health of our current and prospective customers. Any significant weakening of the economy in the United States or Europe and of the global economy, more limited availability of credit, a reduction in business confidence and activity, decreased government spending, and other difficulties may affect one or more of the sectors or countries in which we sell our applications. In addition, a strong dollar could reduce demand for our products in countries with relatively weaker currencies. These adverse conditions could result in reductions in sales of our applications, longer sales cycles, reductions in subscription duration and value, slower adoption of new technologies and increased price competition. Any of these events would likely have an adverse effect on our business, operating results and financial position. In addition, there can be no assurance that enterprise software spending levels would increase following any recovery.

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

Our success and ability to compete depend in part upon our intellectual property. We rely on patent, copyright, trade secret and trademark laws, trade secret protection and confidentiality or license agreements with our employees, customers, partners and others to protect our intellectual property rights. However, the steps we take to protect our intellectual property rights may be inadequate.

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We may be required to spend significant resources to monitor and protect our intellectual property rights. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming and distracting to management and could result in the impairment or loss of portions of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability of our intellectual property rights. Our failure to secure, protect and enforce our intellectual property rights could seriously adversely affect our brand and our business.

We may be sued by third parties for alleged infringement of their proprietary rights.

There is considerable patent and other intellectual property development activity in our industry. Our competitors, as well as a number of other entities and individuals, may own or claim to own intellectual property relating to our industry. From time to time, third parties may claim that we are infringing upon their intellectual property rights, and we may be found to be infringing upon such rights. In the future, they may claim that our applications and underlying technology infringe or violate their intellectual property rights, even if we are unaware of the intellectual property rights that others may claim cover some or all of our technology or services. Any claims or litigation could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, prevent us from offering our services, or require that we comply with other unfavorable terms. We may also be obligated to indemnify our customers or business partners or pay substantial settlement costs, including royalty payments, in connection with any such claim or litigation and to obtain licenses, modify applications, or refund fees, which could be costly. Even if we were to prevail in such a dispute, any litigation regarding our intellectual property could be costly and time-consuming and divert the attention of our management and key personnel from our business operations.

Some of our applications utilize open source software, and any failure to comply with the terms of one or more of these open source licenses could negatively affect our business.

Some of our applications include software covered by open source licenses, which may include, by way of example, GNU General Public License and the Apache License. The terms of various open source licenses have not been interpreted by United States courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to market our applications. By the terms of certain open source licenses, we could be required to release the source code of our proprietary software, and to make our proprietary software available under open source licenses, if we combine our proprietary software with open source software in a certain manner. In the event that portions of our proprietary software are determined to be subject to an open source license, we could be required to publicly release the affected portions of our source code, re-engineer all or a portion of our technologies, or otherwise be limited in the licensing of our technologies, each of which could reduce or eliminate the value of our technologies and services. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third party commercial software, as open source licensors generally do not provide warranties or controls on the origin of the software. Many of the risks associated with usage of open source software cannot be eliminated, and could negatively affect our business.

We employ third-party licensed software for use in or with our applications, and the inability to maintain these licenses or errors in the software we license could result in increased costs, or reduced service levels, which would adversely affect our business.

Our applications incorporate certain third-party software obtained under licenses from other companies. We anticipate that we will continue to rely on such third-party software and development tools from third parties in the future. Although we believe that there are commercially reasonable alternatives to the third-party software we currently license, this may not always be the case, or it may be difficult or costly to replace. In addition, integration of the software used in our applications with new third-party software may require significant work and require substantial investment of our time and resources. To the extent that our applications depend upon the successful operation of third-party software in conjunction with our software, any undetected errors or defects in this third-party software could prevent the deployment or impair the functionality of our applications, delay new application introductions, result in a failure of our applications and injure our reputation. Our use of additional or alternative third-party software would require us to enter into license agreements with third parties.

Changes in laws and regulations related to the Internet or changes in the Internet infrastructure itself may diminish the demand for our applications, and could have a negative impact on our business.

Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations relating to Internet usage. Changes in these laws or regulations could require us to modify our applications in order to comply with these laws or regulations. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet or commerce conducted via the Internet. These laws or charges could limit the growth of Internet-related commerce or communications, or negatively impact demand for Internet-based applications such as ours.

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In addition, businesses could be adversely affected due to delays in the development or adoption of new standards and protocols to handle increased demands of Internet activity, security, reliability, cost, ease of use, accessibility, and quality of service. Businesses have been adversely affected by “viruses,” “worms” and similar malicious programs and have experienced a variety of outages and other delays as a result of damage to Internet infrastructure. These issues could negatively impact demand for our cloud-based applications.

We are obligated to develop and maintain proper and effective internal controls over financial reporting. We may not complete our analysis of our internal controls over financial reporting in a timely manner, or these internal controls may not be determined to be effective, which may adversely affect investor confidence in the accuracy and completeness of our financial reports and the market price of our securities may be negatively affected.

As a public company, we are required to maintain internal controls over financial reporting and to report any material weaknesses in such internal controls. Section 404 of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) requires that we evaluate and determine the effectiveness of our internal controls over financial reporting and provide a management report on the internal controls over financial reporting, which must be attested to by our independent registered public accounting firm. If we have a material weakness in our internal controls over financial reporting, we may not detect errors on a timely basis and our financial statements may be materially misstated.

The process of compiling the system and processing documentation necessary to perform the evaluation needed to comply with Section 404 is challenging and costly. In the future, we may not be able to complete our evaluation, testing and any required remediation in a timely fashion. If we identify material weaknesses in our internal controls over financial reporting, if we are unable to comply with the requirements of Section 404 in a timely manner, if we are unable to assert that our internal controls over financial reporting are effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal controls over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our securities could be negatively affected, and we could become subject to investigations by the New York Stock Exchange (NYSE), the SEC, or other regulatory authorities, which could require additional financial and management resources. In addition, because we use Workday's financial management application, any problems that we experience with financial reporting and compliance could be negatively perceived by prospective or current customers, and negatively impact demand for our applications.

The requirements of being a public company may strain our resources and divert management’s attention.

We are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the listing requirements of the NYSE and other applicable securities rules and regulations. Compliance with these rules and regulations has increased and will continue to increase our legal and financial compliance costs, make some activities more difficult, time-consuming or costly, and increase demand on our systems and resources. In particular, we have incurred and expect to continue to incur significant expenses and devote substantial management effort toward ensuring compliance with the requirements of Section 404 of the Sarbanes-Oxley Act. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management’s attention may be diverted from other business concerns, which could harm our business and operating results.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management’s time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, regulatory authorities may

initiate legal proceedings against us and our business may be harmed.

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We will not be able to utilize a portion of our net operating loss or research tax credit carryforwards, which could adversely affect our profitability.

As of July 31, 2015, we had federal and state net operating loss carryforwards due to prior period losses, which if not utilized will begin to expire in 2025 and 2016 for federal and state purposes, respectively. We also have federal research tax credit carryforwards, which if not utilized will begin to expire in 2025. These net operating loss and research tax credit carryforwards could expire unused and be unavailable to reduce future income tax liabilities, which could adversely affect our profitability. In addition, under Section 382 of the Internal Revenue Code of 1986, as amended (the Code), our ability to utilize net operating loss carryforwards or other tax attributes, such as research tax credits, in any taxable year may be limited if we experience an "ownership change." A Section 382 "ownership change" generally occurs if one or more stockholders or groups of stockholders who own at least 5% of our stock increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. Similar rules may apply under state tax laws. It is possible that an ownership change, or any future ownership change, could have a material effect on the use of our net operating loss carryforwards or other tax attributes, which could adversely affect our profitability.

Adverse tax laws or regulations could be enacted or existing laws could be applied to us or our customers, which could increase the costs of our services and adversely impact our business.

We operate and are subject to taxes in the United States and numerous foreign jurisdictions throughout the world. Changes to federal, state, local or international tax laws on income, sales, use, indirect or other tax laws, statutes, rules, regulations or ordinances on multinational corporations are currently being considered by the United States and other countries where we do business. These contemplated legislative initiatives include, but not limited to, changes to transfer pricing policies and definitional changes to permanent establishment could be applied solely or disproportionately to services provided over the Internet. These contemplated tax initiatives, if finalized and adopted by countries, may ultimately impact our effective tax rate and could adversely affect our sales activity resulting in a negative impact on our operating results and cash flows.

In addition, existing tax laws, statutes, rules, regulations or ordinances could be interpreted, changed, modified or applied adversely to us (possibly with retroactive effect), which could require us or our customers to pay additional tax amounts, as well as require us or our customers to pay fines or penalties and interest for past amounts. If we are unsuccessful in collecting such taxes from our customers, we could be held liable for such costs, thereby adversely impacting our operating results and cash flows. If our customers must pay additional fines or penalties, it could adversely affect demand for our services.

Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.

Generally accepted accounting principles in the United States are subject to interpretation by the Financial Accounting Standards Board (FASB), the SEC, and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

Risks Related to Our Class A Common Stock

Our Chairman and CEO have control over key decision making as a result of their control of a majority of our voting stock.

As of July 31, 2015, our co-founder and Chairman Mr. Duffield, together with his affiliates, held voting rights with respect to 67 million shares of Class B common stock and 0.2 million shares of Class A common stock. In addition, Mr. Duffield holds 0.2 million RSUs, which will be settled in an equivalent number of shares of Class A common stock. As of July 31, 2015, our co-founder and CEO Aneel Bhusri, together with his affiliates, held voting rights with respect to 7 million shares of Class B common stock. In addition, Mr. Bhusri holds exercisable options to acquire 3 million shares of Class B common stock, 1 million shares of Class B restricted stock and 0.3 million RSUs, which will be settled in an equivalent number of shares of Class A common stock. Further, Messrs. Duffield and Bhusri have entered into a voting agreement under which each has granted a voting proxy with respect to certain Class B common stock beneficially owned by him effective upon his death or incapacity as described in our registration statement on Form S-1 filed in connection with our initial public offering. Messrs. Duffield and Bhusri have each initially

designated the other as their respective proxies. Accordingly, upon the death or incapacity of either Mr. Duffield or Mr. Bhusri, the other would individually continue to control the voting of shares subject to the voting proxy. Collectively, the shares described above represent a substantial majority of the voting power of our outstanding capital stock. As a result, Messrs. Duffield and Bhusri have the ability to control the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation, or sale of all or substantially all of our assets. In addition, they have the ability to control the management and affairs of our company as a result of their positions as our Chairman and CEO, respectively, and their ability to control the election of our directors. As board members and officers, Messrs. Duffield and Bhusri owe a fiduciary duty to our stockholders and must act in good faith in a manner they reasonably believe to be in the best interests of our stockholders. As stockholders, even as controlling stockholders, they are entitled to vote their shares in their own interests, which may not always be in the interests of our stockholders generally.

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The dual class structure of our common stock has the effect of concentrating voting control with our Chairman and CEO, and also with other executive officers, directors and affiliates; this will limit or preclude the ability of non-affiliates to influence corporate matters.

Our Class B common stock has ten votes per share and our Class A common stock, which is the stock that is currently publicly traded, has one vote per share. Stockholders who hold shares of Class B common stock, including our executive officers, directors and other affiliates, together hold a substantial majority of the voting power of our outstanding capital stock as of July 31, 2015. Because of the ten-to-one voting ratio between our Class B and Class A common stock, the holders of our Class B common stock collectively will continue to control a majority of the combined voting power of our common stock and therefore be able to control all matters submitted to our stockholders for approval until the conversion of all shares of all Class A and Class B shares to a single class of common stock on the date that is the first to occur of (i) October 11, 2032, (ii) such time as the shares of Class B common stock represent less than 9% of the outstanding Class A and Class B common stock, (iii) nine months following the death of both Mr. Duffield and Mr. Bhusri, or (iv) the date on which the holders of a majority of the shares of Class B common stock elect to convert all shares of Class A common stock and Class B common stock into a single class of common stock. This concentrated control will limit or preclude the ability of non-affiliates to influence corporate matters for the foreseeable future.

Future transfers by holders of Class B common stock will generally result in those shares converting to Class A common stock, subject to limited exceptions, such as certain transfers effected for estate planning purposes. The conversion of Class B common stock to Class A common stock will have the effect, over time, of increasing the relative voting power of those holders of Class B common stock who retain their shares in the long term. If, for example, our Chairman and CEO retain a significant portion of their holdings of Class B common stock for an extended period of time, they could, in the future, continue to control a majority of the combined voting power of our Class A common stock and Class B common stock.

Our stock price has been volatile in the past and may be subject to volatility in the future.

The trading price of our Class A common stock has been volatile historically, and could be subject to wide fluctuations in response to various factors described below. These factors, as well as the volatility of our Class A common stock, could also impact the price of our convertible senior notes. The factors that may affect the trading price of our securities, some of which are beyond our control, include:

- overall performance of the equity markets;
- fluctuations in the valuation of companies perceived by investors to be comparable to us, such as high-growth or cloud companies, or in valuation metrics, such as our price to revenues ratio;
- changes in the estimates of our operating results that we provide to the public, our failure to meet these projections or changes in recommendations by securities analysts that follow our securities;
- announcements of technological innovations, new applications or enhancements to services, acquisitions, strategic alliances or significant agreements by us or by our competitors;
- disruptions in our services due to computer hardware, software or network problems;
- announcements of customer additions and customer cancellations or delays in customer purchases;
- recruitment or departure of key personnel;
- the economy as a whole, market conditions in our industry, and the industries of our customers;
- trading activity by directors, executive officers and significant stockholders, or the perception in the market that the holders of a large number of shares intend to sell their shares;
- the exercise of rights held by certain of our stockholders, subject to some conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or our stockholders;
- the size of our market float and significant option exercises;
- any future issuances of securities;
- sales and purchases of any Class A common stock issued upon conversion of our convertible senior notes or in connection with the convertible note hedge and warrant transactions related to such convertible senior notes;
- our operating performance and the performance of other similar companies; and

- the sale or availability for sale of a large number of shares of our Class A common stock in the public market.

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Additionally, the stock markets have at times experienced extreme price and volume fluctuations that have affected and may in the future affect the market prices of equity securities of many companies. These fluctuations have, in some cases, been unrelated or disproportionate to the operating performance of these companies. Further, the trading prices of publicly traded shares of companies in our industry have been particularly volatile and may be very volatile in the future.

In the past, some companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could harm our business.

We have indebtedness in the form of convertible senior notes.

In June 2013, we completed an offering of $350.0 million of 0.75% convertible senior notes due July 15, 2018 (2018 Notes), and we concurrently issued an additional $250.0 million of 1.50% convertible senior notes due July 15, 2020 (2020 Notes).

As a result of these convertible notes offerings, we incurred $350.0 million principal amount of indebtedness, which we may be required to pay at maturity in 2018, and $250.0 million principal amount of indebtedness, which we may be required to pay at maturity in 2020, or upon the occurrence of a fundamental change (as defined in the applicable indenture). There can be no assurance that we will be able to repay this indebtedness when due, or that we will be able to refinance this indebtedness on acceptable terms or at all. In addition, this indebtedness could, among other things:

- make it difficult for us to pay other obligations;
- make it difficult to obtain favorable terms for any necessary future financing for working capital, capital expenditures, debt service requirements or other purposes;
- require us to dedicate a substantial portion of our cash flow from operations to service and repay the indebtedness, reducing the amount of cash flow available for other purposes; and
- limit our flexibility in planning for and reacting to changes in our business.

Exercise of the warrants associated with our 2018 Notes or our 2020 Notes may affect the price of our Class A common stock.

In connection with our offering of the 2018 Notes, we sold warrants to acquire up to approximately 4.2 million shares of our Class A common stock at an initial strike price of $107.96, which become exercisable beginning on October 15, 2018. In connection with our offering of the 2020 Notes, we sold warrants to acquire up to approximately 3.1 million shares of our Class A common stock at an initial strike price of $107.96, which become exercisable beginning on October 15, 2020. The warrants may be settled in shares or in cash. The exercise of the warrants could have a dilutive effect if the market price per share of our Class A common stock exceeds the strike price of the warrants. The counterparties to the warrant transactions and note hedge transactions relating to the 2018 Notes and the 2020 Notes are likely to enter into or unwind various derivative instruments with respect to our Class A common stock or purchase or sell shares of our Class A common stock or other securities linked to or referencing our Class A common stock in secondary market transactions prior to the respective maturity of the 2018 Notes and the 2020 Notes. These activities could adversely affect the trading price of our Class A common stock.

Delaware law and provisions in our restated certificate of incorporation and restated bylaws could make a merger, tender offer, or proxy contest difficult, thereby depressing the market price of our Class A common stock.

Our status as a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay, or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our restated certificate of incorporation and restated bylaws contain provisions that may make the acquisition of our company more difficult, including the following:

- any transaction that would result in a change in control of our company requires the approval of a majority of our outstanding Class B common stock voting as a separate class;
- our dual class common stock structure, which provides our chairman and CEO with the ability to control the outcome of matters requiring stockholder approval, even if they own significantly less than a majority of the shares of our

outstanding Class A and Class B common stock;

- our board of directors is classified into three classes of directors with staggered three-year terms and directors are only able to be removed from office for cause;

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- when the outstanding shares of our Class B common stock represent less than a majority of the combined voting power of common stock:
- certain amendments to our restated certificate of incorporation or restated bylaws will require the approval of two-thirds of the combined vote of our then-outstanding shares of Class A and Class B common stock;
- our stockholders will only be able to take action at a meeting of stockholders and not by written consent; and
- vacancies on our board of directors will be able to be filled only by our board of directors and not by stockholders;
- only our chairman of the board, chief executive officer, either co-president, or a majority of our board of directors are authorized to call a special meeting of stockholders;
- certain litigation against us can only be brought in Delaware;
- we will have two classes of common stock until the date that is the first to occur of (i) October 11, 2032, (ii) such time as the shares of Class B common stock represent less than 9% of the outstanding Class A and Class B common stock, (iii) nine months following the death of both Mr. Duffield and Mr. Bhusri, or (iv) the date on which the holders of a majority of the shares of Class B common stock elect to convert all shares of Class A common stock and Class B common stock into a single class of common stock;
- our restated certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established, and shares of which may be issued, without the approval of the holders of Class A common stock; and
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for stockholders to elect directors of their choosing and to cause us to take other corporate actions they desire, any of which, under certain circumstances, could depress the market price of our securities.

We have broad discretion in the use of our cash balances and may not use them effectively.

We have broad discretion in the use of our cash balances and may not use them effectively. The failure by our management to apply these funds effectively could adversely affect our business and financial condition. Pending their use, we may invest the net proceeds from these offerings in a manner that does not produce income or that loses value. Our investments may not yield a favorable return to our investors and may negatively impact the price of our securities.

If securities or industry analysts publish inaccurate or unfavorable research about our business, or discontinue publishing research about our business, the price and trading volume of our securities could decline.

The trading market for our securities will depend in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us downgrade our Class A common stock or publish inaccurate or unfavorable research about our business, the price of our securities would likely decline. If one or more of these analysts cease coverage of us or fail to publish reports on us regularly, demand for our securities could decrease, which might cause the price and trading volume of our securities to decline.

We do not intend to pay dividends for the foreseeable future.

We have never declared nor paid cash dividends on our capital stock. We currently intend to retain any future earnings to finance the operation and expansion of our business, and we do not expect to declare or pay any dividends in the foreseeable future. Consequently, stockholders must rely on sales of their common stock after price appreciation as the only way to realize any future gains on their investment.

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

a) Sales of Unregistered Securities

Not applicable.

b) Use of Proceeds from Public Offerings of Common Stock

On October 17, 2012, we closed our initial public offering (IPO), in which we sold 26.2 million shares of Class A common stock at a price to the public of $28.00 per share pursuant to a registration statement on Form S-1 (File No. 333-183640), which was declared effective by the SEC on October 11, 2012.

There has been no material change in the planned use of proceeds from our IPO as described in our final prospectus filed with the SEC on October 15, 2012 pursuant to Rule 424(b).

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

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ITEM 6. EXHIBITS

Exhibits

The Exhibits listed below are filed as part of this Form 10-Q.

Exhibit Number		Incorporation by Reference				Filed Herewith
		Form	File No.	Filing Date	Exhibit No.	
3.1	Amended and Restated Bylaws of the Registrant	8-K	001-35680	June 5, 2015	3.1	
31.1	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.					X
31.2	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.					X
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Schema Linkbase Document					X
101.CAL	XBRL Taxonomy Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Labels Linkbase Document					X
101.PRE	XBRL Taxonomy Presentation Linkbase Document					X

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SIGNATURES

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

Dated: September 4, 2015

Workday, Inc.

/s/ Mark S. Peek
Mark S. Peek
Co-President and Chief Financial Officer
(Principal Financial Officer)

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