SALESFORCE COM INC
Form 10-Q
November 20, 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 October 31, 2015
OR
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-32224

salesforce.com, inc.
(Exact name of registrant as specified in its charter)

Delaware	94-3320693
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

The Landmark @ One Market, Suite 300
San Francisco, California 94105
(Address of principal executive offices)
Telephone Number (415) 901-7000
(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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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 October 31, 2015, there were approximately 664.0 million shares of the Registrant's Common Stock outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
salesforce.com, inc.
Condensed Consolidated Balance Sheets
(in thousands)

	October 31, 2015 (unaudited)	January 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$1,223,318	$908,117
Short-term marketable securities	134,687	87,312
Accounts receivable, net	1,060,726	1,905,506
Deferred commissions	208,133	225,386
Prepaid expenses and other current assets	311,909	280,554
Land and building improvements held for sale	0	143,197
Total current assets	2,938,773	3,550,072
Marketable securities, noncurrent	943,301	894,855
Property and equipment, net	1,742,142	1,125,866
Deferred commissions, noncurrent	148,147	162,796
Capitalized software, net	397,013	433,398
Goodwill	3,849,054	3,782,660
Strategic investments	496,809	175,774
Other assets, net	396,727	452,546
Restricted cash	0	115,015
Total assets	$10,911,966	$10,692,982
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable, accrued expenses and other liabilities	$1,149,693	$1,103,335
Deferred revenue	2,827,285	3,286,768
Total current liabilities	3,976,978	4,390,103
Convertible 0.25% senior notes, net	1,088,910	1,070,692
Loan assumed on 50 Fremont	198,851	0
Revolving credit facility	0	300,000
Deferred revenue, noncurrent	19,225	34,681
Other noncurrent liabilities	878,048	922,323
Total liabilities	6,162,012	6,717,799
Stockholders’ equity:		
Common stock	664	651
Additional paid-in capital	5,410,377	4,604,485
Accumulated other comprehensive loss	(33,325)	(24,108)
Accumulated deficit	(627,762)	(605,845)
Total stockholders’ equity	4,749,954	3,975,183
Total liabilities and stockholders’ equity	$10,911,966	$10,692,982

See accompanying Notes.

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salesforce.com, inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share data)
(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Revenues:				
Subscription and support	$1,596,333	$1,288,513	$4,522,939	$3,668,406
Professional services and other	115,634	95,142	334,879	260,572
Total revenues	1,711,967	1,383,655	4,857,818	3,928,978
Cost of revenues (1)(2):				
Subscription and support	303,045	238,746	870,023	666,611
Professional services and other	120,638	94,465	340,846	266,736
Total cost of revenues	423,683	333,211	1,210,869	933,347
Gross profit	1,288,284	1,050,444	3,646,949	2,995,631
Operating expenses (1)(2):				
Research and development	239,212	195,460	695,440	586,927
Marketing and sales	818,820	709,643	2,349,449	2,020,956
General and administrative	186,818	167,383	544,314	498,565
Operating lease termination resulting from purchase of 50 Fremont, net	0	0	(36,617)	0
Total operating expenses	1,244,850	1,072,486	3,552,586	3,106,448
Income (loss) from operations	43,434	(22,042)	94,363	(110,817)
Investment income	3,507	2,622	11,351	7,055
Interest expense	(18,249)	(17,682)	(53,020)	(56,355)
Other expense (1)(3)	(7,093)	(372)	(6,064)	(15,095)
Gain on sales of land and building improvements	21,792	15,625	21,792	15,625
Income (loss) before provisions for income taxes	43,391	(21,849)	68,422	(159,587)
Provisions for income taxes	(68,548)	(17,075)	(90,339)	(37,336)
Net loss	$(25,157)	$(38,924)	$(21,917)	$(196,923)
Basic net loss per share	$(0.04)	$(0.06)	$(0.03)	$(0.32)
Diluted net loss per share	$(0.04)	$(0.06)	$(0.03)	$(0.32)
Shares used in computing basic net loss per share	664,131	629,548	659,160	619,748
Shares used in computing diluted net loss per share	664,131	629,548	659,160	619,748

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(1) Amounts include amortization of purchased intangibles from business combinations, as follows:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Cost of revenues	$20,296	$20,351	$60,825	$70,294
Marketing and sales	18,966	15,095	57,995	44,708
Other non-operating expense	761	0	2,877	0

(2) Amounts include stock-based expense, as follows:

	Three Months Ended October 31,		Nine Months Ended October 31,	

	2015	2014	2015	2014
Cost of revenues	$17,516	$14,118	$49,237	$38,905
Research and development	31,534	26,868	96,508	87,264
Marketing and sales	69,561	72,892	211,819	210,510
General and administrative	25,706	25,582	77,092	76,284

(3) Amount includes approximately $10.2 million loss on conversions of our convertible 0.75% senior notes due January 2015 recognized during the nine months ended October 31, 2014.

See accompanying Notes.

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salesforce.com, inc.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Net loss	$(25,157)	$(38,924)	$(21,917)	$(196,923)
Other comprehensive loss, before tax and net of reclassification adjustments:				
Foreign currency translation and other losses	(1,173)	(13,692)	(8,419)	(15,876)
Unrealized gains (loss) on investments	(2,873)	1,278	337	(3,055)
Other comprehensive loss, before tax	(4,046)	(12,414)	(8,082)	(18,931)
Tax effect	(1,135)	0	(1,135)	0
Other comprehensive loss, net of tax	(5,181)	(12,414)	(9,217)	(18,931)
Comprehensive loss	$(30,338)	$(51,338)	$(31,134)	$(215,854)

See accompanying Notes.

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salesforce.com, inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Operating activities:				
Net loss	$(25,157)	$(38,924)	$(21,917)	$(196,923)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Depreciation and amortization	134,236	111,954	393,838	330,358
Amortization of debt discount and transaction costs	7,138	9,420	20,290	31,160
Gain on sales of land and building improvements	(21,792)	(15,625)	(21,792)	(15,625)
50 Fremont lease termination, net	0	0	(36,617)	0
Loss on conversions of convertible senior notes	0	1,340	0	10,230
Abandonment of leasehold improvement	7,086	0	7,086	0
Amortization of deferred commissions	78,934	65,371	232,768	186,526
Expenses related to employee stock plans	144,317	139,460	434,656	412,963
Excess tax benefits from employee stock plans	(44,607)	(1,221)	(48,698)	(3,447)
Changes in assets and liabilities, net of business combinations:				
Accounts receivable, net	15,262	39,792	853,014	566,306
Deferred commissions	(80,030)	(64,280)	(200,867)	(171,022)
Prepaid expenses and other current assets and other assets	33,841	6,588	4,495	34,501
Accounts payable, accrued expenses and other liabilities	57,577	(1,933)	12,276	(44,894)
Deferred revenue	(188,898)	(129,431)	(475,357)	(298,642)
Net cash provided by operating activities	117,907	122,511	1,153,175	841,491
Investing activities:				
Business combinations, net of cash acquired	(27,759)	38,071	(58,680)	38,071
Proceeds from land and building improvements held for sale	127,066	192,240	127,066	223,240
Purchase of 50 Fremont land and building	0	0	(425,376)	0
Deposit for purchase of 50 Fremont land and building	0	(114,935)	115,015	(114,935)
Non-refundable amounts received for sale of land available for sale	0	0	6,284	0
Strategic investments	(30,330)	(12,852)	(325,226)	(47,905)
Purchases of marketable securities	(200,001)	(154,560)	(543,422)	(690,024)
Sales of marketable securities	91,153	46,908	414,259	197,293
Maturities of marketable securities	7,166	22,288	23,445	46,248
Capital expenditures	(80,041)	(73,426)	(216,011)	(205,100)
Net cash used in investing activities	(112,746)	(56,266)	(882,646)	(553,112)
Financing activities:				
Proceeds from revolving credit facility, net	0	297,325	0	297,325
Proceeds from employee stock plans	98,016	91,337	367,830	226,561
Excess tax benefits from employee stock plans	44,607	1,221	48,698	3,447

Payments on convertible senior notes	0	(89,645)	0	(387,229)
Principal payments on capital lease obligations	(10,945)	(10,345)	(68,844)	(61,280)
Payments on revolving credit facility and term loan	0	(270,000)	(300,000)	(285,000)
Net cash provided by (used in) financing activities	131,678	19,893	47,684	(206,176)
Effect of exchange rate changes	(2,872)	(14,538)	(3,012)	(17,513)
Net increase in cash and cash equivalents	133,967	71,600	315,201	64,690
Cash and cash equivalents, beginning of period	1,089,351	774,725	908,117	781,635
Cash and cash equivalents, end of period	$1,223,318	$846,325	$1,223,318	$846,325

See accompanying Notes.

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salesforce.com, inc.
Condensed Consolidated Statements of Cash Flows
Supplemental Cash Flow Disclosure
(in thousands)
(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Supplemental cash flow disclosure:				
Cash paid during the period for:				
Interest	$4,085	$4,285	$32,756	$21,274
Income taxes, net of tax refunds	$8,248	$6,187	$24,450	$30,986
Non-cash financing and investing activities:				
Fixed assets acquired under capital leases	$2,065	$38,604	$7,191	$119,939
Building in progress - leased facility acquired under financing obligation	$38,477	$29,756	$75,336	$62,804
Fair value of loan assumed on 50 Fremont	$0	$0	$198,751	$0
Fair value of common stock issued as consideration for business combinations	$0	$338,033	$0	$338,033

See accompanying Notes.

salesforce.com, inc.
Notes to Condensed Consolidated Financial Statements

1. Summary of Business and Significant Accounting Policies

Description of Business

Salesforce.com, inc. (the “Company”) is a leading provider of enterprise cloud computing services. The Company is dedicated to helping customers of all sizes and industries worldwide transform themselves into “customer companies” by empowering them to connect with their customers, partners, employees and products in entirely new ways. The Company provides customers with the solutions they need to build a next generation social front office with social and mobile cloud technologies.

Fiscal Year

The Company’s fiscal year ends on January 31. References to fiscal 2016, for example, refer to the fiscal year ending January 31, 2016.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of October 31, 2015 and the condensed consolidated statements of operations, the condensed consolidated statements of comprehensive loss and the condensed consolidated statements of cash flows for the three and nine months ended October 31, 2015 and 2014, respectively, are unaudited. The condensed consolidated balance sheet data as of January 31, 2015 was derived from the audited consolidated financial statements that are included in the Company’s fiscal 2015 Form 10-K, which was filed with the Securities and Exchange Commission (the “SEC”) on March 6, 2015. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company’s fiscal 2015 Form 10-K.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information. Accordingly, they do not include all of the financial information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of the Company’s management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in the Form 10-K, and include all adjustments necessary for the fair presentation of the Company’s balance sheet as of October 31, 2015, and its results of operations, including its comprehensive loss, and its cash flows for the three and nine months ended October 31, 2015 and 2014. All adjustments are of a normal recurring nature. The results for the three and nine months ended October 31, 2015 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2016.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in the Company’s condensed consolidated financial statements and notes thereto.

Significant estimates and assumptions made by management include the determination of:

- the best estimate of selling price of the deliverables included in multiple deliverable revenue arrangements,
- the fair value of assets acquired and liabilities assumed for business combinations,
- the recognition, measurement and valuation of current and deferred income taxes,
- the fair value of convertible notes,
- the fair value of stock awards issued and related forfeiture rates,
- the useful lives of intangible assets and property and equipment,
- the valuation of strategic investments and the determination of other-than-temporary impairments, and
- the assessment of determination of impairment of long-lived assets (property and equipment, goodwill and identified intangibles).

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Actual results could differ materially from those estimates. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the result of which forms the basis for making judgments about the carrying values of assets and liabilities.

Principles of Consolidation

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

Segments

The Company operates as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, who is the chief executive officer, in deciding how to allocate resources and assessing performance. Over the past few years, the Company has completed several acquisitions. These acquisitions have allowed the Company to expand its offerings, presence and reach in various market segments of the enterprise cloud computing market. While the Company has offerings in multiple enterprise cloud computing market segments, the Company's business operates in one operating segment because all of the Company's offerings operate on a single platform and are deployed in an identical way, and the Company's chief operating decision maker evaluates the Company's financial information and resources and assesses the performance of these resources on a consolidated basis. Since the Company operates in one operating segment, all required financial segment information can be found in the condensed consolidated financial statements.

Concentrations of Credit Risk and Significant Customers

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities and trade accounts receivable. Although the Company deposits its cash with multiple financial institutions, its deposits, at times, may exceed federally insured limits. Collateral is not required for accounts receivable. The Company maintains an allowance for doubtful accounts receivable balances. This allowance is based upon historical loss patterns, the number of days that billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts.

No single customer accounted for more than five percent of accounts receivable at October 31, 2015 and January 31, 2015. No single customer accounted for five percent or more of total revenue during the three and nine months ended October 31, 2015 and 2014.

Geographic Locations

As of October 31, 2015 and January 31, 2015, assets located outside the Americas were nine percent and 12 percent of total assets, respectively.

Revenues by geographical region are as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Americas	$1,258,148	$995,331	$3,575,441	$2,812,654
Europe	302,704	252,982	848,413	730,324
Asia Pacific	151,115	135,342	433,964	386,000
	$1,711,967	$1,383,655	$4,857,818	$3,928,978

Americas revenue attributed to the United States was approximately 95 percent and 94 percent during the three and nine months ended October 31, 2015 and 2014. No other country represented more than ten percent of total revenue during the three and nine months ended October 31, 2015 and 2014.

Revenue Recognition

The Company derives its revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing the Company's enterprise cloud computing services and from customers paying for additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue. "Other revenue" consists primarily of training fees.

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The Company commences revenue recognition when all of the following conditions are satisfied:

- there is persuasive evidence of an arrangement;
- the service has been or is being provided to the customer;
- the collection of the fees is reasonably assured; and
- the amount of fees to be paid by the customer is fixed or determinable.

The Company’s subscription service arrangements are non-cancelable and do not contain refund-type provisions.

Subscription and Support Revenues

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement date of each contract, which is the date the Company’s service is made available to customers.

Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Professional Services and Other Revenues

The majority of the Company’s professional services contracts are on a time and material basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized as the services are performed.

Multiple Deliverable Arrangements

The Company enters into arrangements with multiple deliverables that generally include multiple subscriptions, premium support and professional services. If the deliverables have standalone value upon delivery, the Company accounts for each deliverable separately. Subscription services have standalone value as such services are often sold separately. In determining whether professional services have standalone value, the Company considers the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date and the contractual dependence of the subscription service on the customer’s satisfaction with the professional services work. To date, the Company has concluded that all of the professional services included in multiple deliverable arrangements executed have standalone value.

Multiple deliverables included in an arrangement are separated into different units of accounting and the arrangement consideration is allocated to the identified separate units based on a relative selling price hierarchy. The Company determines the relative selling price for a deliverable based on its vendor-specific objective evidence of selling price (“VSOE”), if available, or its best estimate of selling price (“BESP”), if VSOE is not available. The Company has determined that third-party evidence of selling price (“TPE”) is not a practical alternative due to differences in its service offerings compared to other parties and the availability of relevant third-party pricing information. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

For certain professional services, the Company has established VSOE as a consistent number of standalone sales of these deliverables have been priced within a reasonably narrow range. The Company has not established VSOE for its subscription services due to lack of pricing consistency, the introduction of new services and other factors. Accordingly, the Company uses its BESP to determine the relative selling price for its subscription services.

The Company determines BESP by considering its overall pricing objectives and market conditions. Significant pricing practices taken into consideration include the Company’s discounting practices, the size and volume of the Company’s transactions, the customer demographic, the geographic area where services are sold, price lists, its go-to-market strategy, historical standalone sales and contract prices. The determination of BESP is made through consultation with and approval by the Company’s management, taking into consideration the go-to-market strategy. As the Company’s go-to-market strategies evolve, the Company may modify its pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BESP.

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Deferred Revenue

The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription services described above and is recognized as the revenue recognition criteria are met. The Company generally invoices customers in annual installments. The deferred revenue balance is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing, size and new business linearity within the quarter.

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

Deferred Commissions

Deferred commissions are the incremental costs that are directly associated with non-cancelable subscription contracts with customers and consist of sales commissions paid to the Company’s direct sales force.

The commissions are deferred and amortized over the non-cancelable terms of the related customer contracts, which are typically 12 to 36 months. The commission payments are paid in full the month after the customer’s service commences and are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. The Company believes this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the same period that the subscription revenue is recognized. Amortization of deferred commissions is included in marketing and sales expense in the accompanying condensed consolidated statements of operations.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents are stated at fair value.

Marketable Securities

Management determines the appropriate classification of marketable securities at the time of purchase and reevaluates such determination at each balance sheet date. Securities are classified as available for sale and are carried at fair value, with the change in unrealized gains and losses, net of tax, reported as a separate component on the condensed consolidated statements of comprehensive loss. Fair value is determined based on quoted market rates when observable or utilizing data points that are observable, such as quoted prices, interest rates and yield curves. Declines in fair value judged to be other-than-temporary on securities available for sale are included as a component of investment income. In order to determine whether a decline in value is other-than-temporary, the Company evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value and its intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. The cost of securities sold is based on the specific-identification method. Interest on securities classified as available for sale is also included as a component of investment income.

Fair Value Measurement

The Company measures its cash equivalents, marketable securities and foreign currency derivative contracts at fair value.

The additional disclosures regarding the Company’s fair value measurements are included in Note 2 “Investments.”

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated useful lives of those assets as follows:

Computer, equipment and software	3 to 9 years
Furniture and fixtures	5 years
Leasehold improvements	The remaining lease term or up to 10 years

When assets are retired or otherwise disposed of, the cost and accumulated depreciation and amortization are removed from their respective accounts and any loss on such retirement is reflected in operating expenses.

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Capitalized Internal-Use Software Costs
The Company capitalizes costs related to its enterprise cloud computing services and certain projects for internal use incurred during the application development stage. Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its estimated useful life, which is generally three to five years. Management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.
Goodwill and Intangible Assets Impairment Assessments
The Company evaluates and tests the recoverability of its goodwill for impairment at least annually during the fourth quarter or more often if and when circumstances indicate that goodwill may not be recoverable.
Intangible assets are amortized over their useful lives. Each period the Company evaluates the estimated remaining useful life of its intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization. The carrying amounts of these assets are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of each asset to the future undiscounted cash flows the asset is expected to generate. If the undiscounted cash flows used in the test for recoverability are less than the carrying amount of these assets, then the carrying amount of such assets is reduced to fair value.
Long- Lived Assets and Impairment Assessment
The company evaluates long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. This includes but is not limited to significant adverse changes in business climate, market conditions, or other events that indicate an asset's carrying amount may not be recoverable. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value.
Business Combinations
The Company uses its best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date. The Company’s estimates are inherently uncertain and subject to refinement. During the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the fair value of these tangible and intangible assets acquired and liabilities assumed, with the corresponding offset to goodwill. In addition, uncertain tax positions and tax-related valuation allowances are initially established in connection with a business combination as of the acquisition date. The Company continues to collect information and reevaluates these estimates and assumptions quarterly and records any adjustments to the Company’s preliminary estimates to goodwill provided that the Company is within the measurement period. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company’s condensed consolidated statements of operations.
Leases and Asset Retirement Obligations
The Company categorizes leases at their inception as either operating or capital leases. In certain lease agreements, the Company may receive rent holidays and other incentives. The Company recognizes lease costs on a straight-line basis once control of the space is achieved, without regard to deferred payment terms such as rent holidays that defer the commencement date of required payments. Additionally, incentives received are treated as a reduction of costs over the term of the agreement.
The Company establishes assets and liabilities for the present value of estimated future costs to retire long-lived assets at the termination or expiration of a lease. Such assets are depreciated over the lease period to operating expense.
In the event the Company is the deemed owner for accounting purposes during construction, the Company records assets and liabilities for the estimated construction costs incurred under build-to-suit lease arrangements to the extent it is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease.

The Company additionally has entered into subleases for unoccupied leased office space. Losses are recognized in the period the sublease is executed. Any sublease payments received in excess of the straight-line rent payments for the sublease are recorded in other income (expense).

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Accounting for Stock-Based Expense

The Company recognizes stock-based expenses related to stock options and restricted stock awards on a straight-line basis over the requisite service period of the awards, which is generally the vesting term of four years. The Company recognizes stock-based expenses related to shares issued pursuant to its Amended and Restated 2004 Employee Stock Purchase Plan (“ESPP” or “2004 Employee Stock Purchase Plan”) on a straight-line basis over the offering period, which is 12 months. Stock-based expenses are recognized net of estimated forfeiture activity. The estimated forfeiture rate applied is based on historical forfeiture rates. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option pricing model.

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

	Three Months Ended October 31,				Nine Months Ended October 31,			
Stock Options	2015		2014		2015		2014	
Volatility	35	%	37	%	35-37	%	37	%
Estimated life	3.6 years		3.5 years		3.6 years		3.5 years	
Risk-free interest rate	1.21-1.27	%	1.34-1.53	%	1.13-1.42	%	1.20-1.53	%
Weighted-average fair value per share of grants	$19.72		$17.32		$19.79		$16.46	

	Three Months Ended October 31,		Nine Months Ended October 31,			
ESPP	2015	2014	2015		2014	
Volatility	n/a	n/a	34	%	34-35	%
Estimated life	n/a	n/a	0.75 years		0.75 years	
Risk-free interest rate	n/a	n/a	0.06-0.27	%	0.07-0.16	%
Weighted-average fair value per share of grants	n/a	n/a	$19.30		$14.53	

The Company estimated its future stock price volatility considering both its observed option-implied volatilities and its historical volatility calculations. Management believes this is the best estimate of the expected volatility over the expected life of its stock options and stock purchase rights.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax laws is recognized in the condensed consolidated statement of operations in the period that includes the enactment date.

Valuation allowances are established when necessary to reduce deferred tax assets to the amounts that are more likely than not expected to be realized based on the weighting of positive and negative evidence. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback or carryforward periods available under the applicable tax law. The Company regularly reviews the deferred tax assets for recoverability based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. The Company’s judgments regarding future profitability may change due to many factors, including future market conditions and the ability to successfully execute its business plans and/or tax planning strategies. Should there be a change in the ability to recover deferred tax assets, the tax provision would increase or decrease in the period in which the assessment is changed.

The Company’s tax positions are subject to income tax audits by multiple tax jurisdictions throughout the world. The Company recognizes the tax benefit of an uncertain tax position only if it is more likely than not that the position is sustainable upon examination by the taxing authority, solely based on its technical merits. The tax benefit recognized

is measured as the largest amount of benefit which is greater than 50 percent likely to be realized upon settlement with the taxing authority. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in the income tax provision.

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Foreign Currency Translation

The functional currency of the Company's major foreign subsidiaries is generally the local currency. Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are recorded as a separate component on the condensed consolidated statements of comprehensive loss. Foreign currency transaction gains and losses are included in net loss for the period. All assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the exchange rate on the balance sheet date. Revenues and expenses are translated at the average exchange rate during the period. Equity transactions are translated using historical exchange rates.

Warranties and Indemnification

The Company's enterprise cloud computing services are typically warranted to perform in a manner consistent with general industry standards that are reasonably applicable and materially in accordance with the Company's online help documentation under normal use and circumstances.

The Company's arrangements generally include certain provisions for indemnifying customers against liabilities if its products or services infringe a third party's intellectual property rights. To date, the Company has not incurred any material costs as a result of such obligations and has not accrued any liabilities related to such obligations in the accompanying condensed consolidated financial statements.

The Company has also agreed to indemnify its directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person's service as a director or officer, including any action by the Company, arising out of that person's services as the Company's director or officer or that person's services provided to any other company or enterprise at the Company's request. The Company maintains director and officer insurance coverage that would generally enable the Company to recover a portion of any future amounts paid. The Company may also be subject to indemnification obligations by law with respect to the actions of its employees under certain circumstances and in certain jurisdictions.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09") which amended the existing FASB Accounting Standards Codification. This standard establishes a principle for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. The standard also provides guidance on the recognition of costs related to obtaining and fulfilling customer contracts. The FASB deferred the effective date for the new revenue reporting standard for entities reporting under U.S. GAAP for one year. In accordance with the deferral, ASU 2014-09 will be effective for fiscal 2019, including interim periods within that reporting period. The Company is currently in the process of assessing the adoption methodology, which allows the amendment to be applied retrospectively to each prior period presented, or with the cumulative effect recognized as of the date of initial application. The Company is also evaluating the impact of the adoption of ASU 2014-09 on its condensed consolidated financial statements and has not determined whether the effect will be material to either its revenue results or its deferred commissions balances.

In May 2013, FASB issued Accounting Standards Update No. 2013-270, "a revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)" ("ASU 2013-270"), to place leases on lessee's balance sheets. ASU 2013-270 states a lessee would recognize a lease liability for lease payments and recognize an asset for its right to use the leased asset during the lease term. In November 2015, FASB set an effective date for annual periods after December 2018. The Company plans to adopt ASU 2013-270 in fiscal 2020 and is currently evaluating the impact to its condensed consolidated financial statements.

In September 2015, the FASB issued Accounting Standards Update No. 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments (Topic 805)" ("ASU 2015-16") which eliminates the requirement to restate prior period financial statements for measurement period adjustments. ASU 2015-16 requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. The new standard is effective for interim and annual periods beginning after December 15, 2015 and early adoption is permitted. The Company is evaluating the impact of the adoption of ASU 2015-16 on its condensed consolidated financial statements.

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Reclassification

Certain reclassifications to the fiscal 2015 balances were made to conform to the current period presentation in the Balance Sheet. These reclassifications include strategic investments and other assets, net.

2. Investments

Marketable Securities

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

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses		Fair Value
Corporate notes and obligations	$636,779	$905	$(1,678	)	$636,006
U.S. treasury securities	126,837	149	(42	)	126,944
Mortgage backed obligations	84,288	94	(401	)	83,981
Asset backed securities	176,633	73	(240	)	176,466
Municipal securities	36,358	141	(30	)	36,469
Foreign government obligations	2,094	16	(2	)	2,108
U.S. agency obligations	8,998	5	(9	)	8,994
Covered bonds	6,863	157	0		7,020
Total marketable securities	$1,078,850	$1,540	$(2,402	)	$1,077,988

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

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses		Fair Value
Corporate notes and obligations	$605,724	$3,031	$(481	)	$608,274
U.S. treasury securities	73,226	257	(1	)	73,482
Mortgage backed obligations	44,181	159	(415	)	43,925
Asset backed securities	120,049	131	(43	)	120,137
Municipal securities	36,447	115	(25	)	36,537
Foreign government obligations	12,023	278	0		12,301
U.S. agency obligations	19,488	26	(4	)	19,510
Covered bonds	66,816	1,185	0		68,001
Total marketable securities	$977,954	$5,182	$(969	)	$982,167

The duration of the investments classified as marketable securities is as follows (in thousands):

	As of October 31, 2015	January 31, 2015
Recorded as follows:		
Short-term (due in one year or less)	$134,687	$87,312
Long-term (due after one year)	943,301	894,855
	$1,077,988	$982,167

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As of October 31, 2015, the following marketable securities were in an unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate notes and obligations	$330,654	$(1,382)	$51,475	$(296)	$382,129	$(1,678)
U.S. treasury securities	47,184	(42)	0	0	47,184	(42)
Mortgage backed obligations	51,412	(298)	9,143	(103)	60,555	(401)
Asset backed securities	122,349	(212)	7,398	(28)	129,747	(240)
Municipal securities	3,990	(18)	3,949	(12)	7,939	(30)
Foreign government obligations	1,576	(2)	0	0	1,576	(2)
U.S. agency obligations	4,991	(9)	0	0	4,991	(9)
	$562,156	$(1,963)	$71,965	$(439)	$634,121	$(2,402)

The unrealized losses for each of the fixed rate marketable securities were less than $74,000. The Company does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of October 31, 2015. The Company expects to receive the full principal and interest on all of these marketable securities.

Fair Value Measurement

All of the Company's cash equivalents, marketable securities and foreign currency derivative contracts are classified within Level 1 or Level 2 because the Company's cash equivalents, marketable securities and foreign currency derivative contracts are valued using quoted market prices or alternative pricing sources and models utilizing observable market inputs.

The Company uses a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1. Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2. Other inputs that are directly or indirectly observable in the marketplace.

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

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The following table presents information about the Company's assets and liabilities that are measured at fair value as of October 31, 2015 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of October 31, 2015
Cash equivalents (1):				
Time deposits	$ 0	$235,695	$0	$235,695
Money market mutual funds	339,446	0	0	339,446
Marketable securities:				
Corporate notes and obligations	0	636,006	0	636,006
U.S. treasury securities	0	126,944	0	126,944
Mortgage backed obligations	0	83,981	0	83,981
Asset backed securities	0	176,466	0	176,466
Municipal securities	0	36,469	0	36,469
Foreign government obligations	0	2,108	0	2,108
U.S. agency obligations	0	8,994	0	8,994
Covered bonds	0	7,020	0	7,020
Foreign currency derivative contracts (2)	0	7,789	0	7,789
Total Assets	$ 339,446	$1,321,472	$0	$1,660,918
Liabilities				
Foreign currency derivative contracts (3)	$ 0	$5,996	$0	$5,996
Total Liabilities	$ 0	$5,996	$0	$5,996

(1)Included in "cash and cash equivalents" in the accompanying condensed consolidated balance sheet as of October 31, 2015, in addition to $648.2 million of cash.
(2)Included in "prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheet as of October 31, 2015.
(3)Included in "accounts payable, accrued expenses and other liabilities" in the condensed consolidated balance sheet as of October 31, 2015.

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The following table presents information about the Company's assets and liabilities that are measured at fair value as of January 31, 2015 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of January 31, 2015
Cash equivalents (1):				
Time deposits	$ 0	$292,487	$0	$292,487
Money market mutual funds	13,983	0	0	13,983
Marketable securities:				
Corporate notes and obligations	0	608,274	0	608,274
U.S. treasury securities	0	73,482	0	73,482
Mortgage backed obligations	0	43,925	0	43,925
Asset backed securities	0	120,137	0	120,137
Municipal securities	0	36,537	0	36,537
Foreign government obligations	0	12,301	0	12,301
U.S. agency obligations	0	19,510	0	19,510
Covered bonds	0	68,001	0	68,001
Foreign currency derivative contracts (2)	0	10,611	0	10,611
Total Assets	$ 13,983	$1,285,265	$0	$1,299,248
Liabilities				
Foreign currency derivative contracts (3)	$ 0	$5,694	$0	$5,694
Total Liabilities	$ 0	$5,694	$0	$5,694

(1)Included in "cash and cash equivalents" in the accompanying condensed consolidated balance sheet as of January 31, 2015, in addition to $601.6 million of cash.
(2)Included in "prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheet as of January 31, 2015.
(3)Included in "accounts payable, accrued expenses and other liabilities" in the accompanying condensed consolidated balance sheet as of January 31, 2015.

Derivative Financial Instruments

The Company enters into foreign currency derivative contracts with financial institutions to reduce foreign exchange risk. The Company uses forward currency derivative contracts to minimize the Company's exposure to balances primarily denominated in British pounds, Euros, Japanese yen, Canadian dollars and Australian dollars. The Company's foreign currency derivative contracts, which are not designated as hedging instruments, are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. The Company's derivative financial instruments program is not designated for trading or speculative purposes. As of October 31, 2015 and January 31, 2015, the foreign currency derivative contracts that were not settled were recorded at fair value on the condensed consolidated balance sheets.

Foreign currency derivative contracts are marked-to-market at the end of each reporting period with gains and losses recognized as other expense to offset the gains or losses resulting from the settlement or remeasurement of the underlying foreign currency denominated receivables and payables. While the contract or notional amount is often used to express the volume of foreign currency derivative contracts, the amounts potentially subject to credit risk are generally limited to the amounts, if any, by which the counterparties' obligations under the agreements exceed the obligations of the Company to the counterparties.

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Details on outstanding foreign currency derivative contracts related primarily to intercompany receivables and payables are presented below (in thousands):

	As of	
	October 31, 2015	January 31, 2015
Notional amount of foreign currency derivative contracts	$1,067,250	$942,086
Fair value of foreign currency derivative contracts	$1,793	$4,917

The fair value of the Company's outstanding derivative instruments are summarized below (in thousands):

		Fair Value of Derivative Instruments As of	
	Balance Sheet Location	October 31, 2015	January 31, 2015
Derivative Assets			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Prepaid expenses and other current assets	$7,789	$10,611
Derivative Liabilities			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Accounts payable, accrued expenses and other liabilities	$5,996	$5,694

The effect of the derivative instruments not designated as hedging instruments on the condensed consolidated statements of operations during the three and nine months ended October 31, 2015 and 2014, respectively, are summarized below (in thousands):

Derivatives Not Designated as Hedging Instruments	Losses on Derivative Instruments Recognized in Income		
		Three Months Ended October 31,	
	Location	2015	2014
Foreign currency derivative contracts	Other expense	$(2,888)	$(3,068)

Derivatives Not Designated as Hedging Instruments	Gains (Losses) on Derivative Instruments Recognized in Income		
		Nine Months Ended October 31,	
	Location	2015	2014
Foreign currency derivative contracts	Other expense	$9,773	$(2,964)

Strategic Investments

The Company's strategic investments are comprised of marketable equity securities and non-marketable debt and equity securities. Marketable equity securities are measured using quoted prices in their respective active markets and the non-marketable equity and debt securities are recorded at cost. These investments are presented on the condensed consolidated balance sheets within strategic investments.

As of October 31, 2015, the Company had six investments in marketable equity securities with a fair value of $26.0 million, which includes an unrealized gain of $18.3 million. As of January 31, 2015, the Company had four investments in marketable equity securities with a fair value of $17.8 million, which included an unrealized gain of $13.1 million. The change

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in the fair value of the investments in publicly held companies is recorded in the condensed consolidated balance sheets within strategic investments and accumulated other comprehensive loss.

The Company's interest in non-marketable debt and equity securities consists of noncontrolling debt and equity investments in privately held companies. The Company's investments in these privately held companies are reported at cost or marked down to fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. These investments are valued using significant unobservable inputs or data in an inactive market and the valuation requires the Company's judgment due to the absence of market prices and inherent lack of liquidity.

As of October 31, 2015 and January 31, 2015, the carrying value of the Company's non-marketable debt and equity securities was $470.8 million and $158.0 million, respectively. The estimated fair value of the non-marketable debt and equity securities was approximately $654.0 million and $280.0 million as of October 31, 2015 and January 31, 2015, respectively. These investments are measured using the cost method of accounting, therefore the unrealized gains of $183.2 million and $122.0 million as of October 31, 2015 and January 31, 2015, respectively, are not recorded in the condensed consolidated financial statements.

Investment Income

Investment income consists of interest income, realized gains, and realized losses on the Company's cash, cash equivalents and marketable securities. The components of investment income are presented below (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Interest income	$3,700	$2,720	$9,919	$7,051
Realized gains	257	78	3,197	424
Realized losses	(450)	(176)	(1,765)	(420)
Total investment income	$3,507	$2,622	$11,351	$7,055

Reclassification adjustments out of accumulated other comprehensive loss into net income (loss) were immaterial for the three and nine months ended October 31, 2015 and 2014, respectively.

3. Property and Equipment

Property and Equipment

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

	As of	
	October 31, 2015	January 31, 2015
Land	$183,888	$0
Buildings	614,349	125,289
Computers, equipment and software	1,259,210	1,171,762
Furniture and fixtures	77,606	71,881
Leasehold improvements	450,565	376,761
	$2,585,618	$1,745,693
Less accumulated depreciation and amortization	(843,476)	(619,827)
	$1,742,142	$1,125,866

Depreciation and amortization expense totaled $77.4 million and $64.6 million during the three months ended October 31, 2015 and 2014, respectively, and totaled $226.6 million and $181.7 million during the nine months ended October 31, 2015 and 2014, respectively.

Computers, equipment and software at October 31, 2015 and January 31, 2015 included a total of $743.3 million and $734.7 million acquired under capital lease agreements, respectively. Accumulated amortization relating to computers, equipment and software under capital leases totaled $285.4 million and $206.7 million, respectively, at October 31, 2015 and January 31, 2015. Amortization of assets under capital leases is included in depreciation and amortization expense.

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In October 2015, the Company sold approximately 8.8 net acres of undeveloped real estate and the associated perpetual parking rights in San Francisco, California, which were classified as held for sale. The total proceeds from the sale were $157.1 million, of which the Company received $127.1 million during the three months ended October 31, 2015 and previously received a nonrefundable deposit in the amount of $30.0 million during the three months ended April 30, 2014. The Company recognized a gain of $21.8 million, net of closing costs, on the sale of this portion of the Company’s land and building improvements and perpetual parking rights.

In December 2012, the Company entered into a lease agreement for approximately 445,000 rentable square feet of office space at 350 Mission Street (“350 Mission”) in San Francisco, California. The space rented is for the total office space available in the building. As a result of the Company’s involvement during the building's construction, the Company is considered for accounting purposes to be the owner of the building. As of October 31, 2015, the Company had capitalized $175.9 million of construction costs, based on the construction costs incurred to date by the landlord, and recorded a corresponding current and noncurrent financing obligation liability of $11.9 million and $194.4 million, respectively. The financing obligation carrying value also includes $25.0 million of tenant improvement obligations and approximately $5.7 million of imputed interest. The total expected financing obligation associated with this lease upon completion of the construction of the building, inclusive of the amounts currently recorded, is $335.5 million, including interest (see Note 10 “Commitments” for future commitment details). The obligation will be settled through monthly lease payments to the landlord in phases as the office space becomes ready for occupancy. To the extent that operating expenses for 350 Mission are material, the Company, as the deemed accounting owner, will record the operating expenses. In April 2015, the building was placed into service and depreciation commenced.

There was no impairment of long-lived assets during the three and nine months ended October 31, 2015 and 2014, respectively.

4. Business Combinations

50 Fremont

In February 2015, the Company acquired 50 Fremont Street, a 41-story building totaling approximately 817,000 rentable square feet located in San Francisco, California (“50 Fremont”). At the time of the acquisition, the Company was leasing approximately 500,000 square feet of the available space in 50 Fremont. As of October 31, 2015, the Company occupied approximately 567,000 square feet. The Company acquired 50 Fremont for the purpose of expanding its global headquarters in San Francisco. Pursuant to the acquisition agreement, the Company also acquired existing third-party leases and other intangible property, terminated the Company’s existing office leases with the seller and assumed the seller's outstanding loan on 50 Fremont. In accordance with Accounting Standards Codification 805 (“ASC 805”), Business Combinations, the Company accounted for the building purchase as a business combination.

The purchase consideration for the corporate headquarters building was as follows (in thousands):

	Fair Value
Cash	$435,189
Loan assumed on 50 Fremont	200,000
Prorations due to ownership transfer midmonth	2,411
Total purchase consideration	$637,600

The following table summarizes the fair values of net tangible and intangible assets acquired (in thousands):

	Fair Value
Building	$435,390
Land	183,888
Termination of salesforce operating lease	9,483
Acquired lease intangibles	7,590
Loan assumed on 50 Fremont fair market value adjustment	1,249
Total	$637,600

To fund the purchase of 50 Fremont, the Company used $115.0 million of restricted cash that the Company had on the balance sheet as of January 31, 2015.

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In connection with the purchase, the Company recognized a net non-cash gain totaling approximately $36.6 million on the termination of the lease signed in January 2012. This amount reflects a gain of $46.1 million for the reversal of tenant incentives provided from the previous landlord at the inception of the lease and a loss of $9.5 million related to the termination of the Company's operating lease. The tax impact as a result of the difference between tax and book basis of the building is insignificant after considering the impact of the Company's valuation allowance. The amounts above have been included in the Company's condensed consolidated statements of operations and condensed consolidated balance sheet. The Company has included the rental income from third party leases with other tenants in the building, and the proportionate share of building expenses for those leases in other expense in the Company's condensed consolidated results of operations from the date of acquisition. These amounts are recorded in other expense as this net rental income is not part of our core operations. These amounts were not material for the periods presented. The Company expects to finalize the depreciable life of the building as soon as practicable, but not later than one year from the acquisition date.

Other Business Combinations

During the nine months ended October 31, 2015, the Company acquired several companies for an aggregate of $60.1 million in cash, net of cash acquired, and has included the financial results of these companies in its condensed consolidated financial statements from the respective dates of acquisition. The Company accounted for these transactions as business combinations. In allocating the purchase consideration for each company based on estimated fair values, the Company recorded $66.4 million of goodwill. Some of the goodwill balance associated with these transactions is deductible for U.S. income tax purposes. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

Goodwill

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill amounts are not amortized, but rather tested for impairment at least annually during the fourth quarter.

Goodwill consisted of the following (in thousands):

Balance as of January 31, 2015	$3,782,660
Other business combinations	66,394
Balance as of October 31, 2015	$3,849,054

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5. Debt

Convertible Senior Notes

(In thousands)	Par Value Outstanding	Equity Component Recorded at Issuance		Liability Component of Par Value as of October 31, 2015	Liability Component of Par Value as of January 31, 2015
0.25% Convertible Senior Notes due April 1, 2018	$1,150,000	$122,421	(1)	$ 1,088,910	$ 1,070,692

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(1)This amount represents the equity component recorded at the initial issuance of the 0.25% convertible senior notes.

In March 2013, the Company issued at par value $1.15 billion of 0.25% convertible senior notes (the “0.25% Senior Notes”, or the “Notes”) due April 1, 2018, unless earlier purchased by the Company or converted. Interest is payable semi-annually, in arrears on April 1 and October 1 of each year.

The 0.25% Senior Notes are governed by an indenture between the Company, as issuer, and U.S. Bank National Association, as trustee. The 0.25% Senior Notes are unsecured and do not contain any financial covenants or any restrictions on the payment of dividends, the incurrence of senior debt or other indebtedness, or the issuance or repurchase of securities by the Company.

If converted, holders of the 0.25% Senior Notes will receive cash equal to the principal amount, and at the Company’s election, cash, shares of the Company’s common stock, or a combination of cash and shares, for any amounts in excess of the principal amounts.

Certain terms of the conversion features of the 0.25% Senior Notes are as follows:

	Conversion Rate per $1,000 Par Value	Initial Conversion Price per Share	Convertible Date
0.25% Senior Notes	15.0512	$66.44	January 1, 2018

Throughout the term of the 0.25% Senior Notes, the conversion rate may be adjusted upon the occurrence of certain events, including any cash dividends. Holders of the 0.25% Senior Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Accrued but unpaid interest will be deemed to be paid in full upon conversion rather than canceled, extinguished or forfeited.

Holders may convert the 0.25% Senior Notes under the following circumstances:

- during any fiscal quarter, if, for at least 20 trading days during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sales price of the Company’s common stock for such trading day is greater than or equal to 130% of the applicable conversion price on such trading day;
- in certain situations, when the trading price of the 0.25% Senior Notes is less than 98% of the product of the sale price of the Company’s common stock and the conversion rate;
- upon the occurrence of specified corporate transactions described under the 0.25% Senior Notes indenture, such as a consolidation, merger or binding share exchange; or
- at any time on or after the convertible date noted above.

Holders of the 0.25% Senior Notes have the right to require the Company to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, such as a change of control, at a purchase price equal to 100% of the principal amount of the 0.25% Senior Notes plus accrued and unpaid interest. Following certain corporate transactions that constitute a change of control, the Company will increase the conversion rate for a holder who elects to convert the 0.25% Senior Notes in connection with such change of control.

In accounting for the issuances of the 0.25% Senior Notes, the Company separated the 0.25% Senior Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component

from the par value of the 0.25% Senior Notes as a whole. The excess of the principal amount of the liability component over its carrying amount (“debt discount”) is amortized to interest expense over the term of the 0.25% Senior Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

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In accounting for the transaction costs related to the 0.25% Senior Notes issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Transaction costs attributable to the liability component are being amortized to expense over the terms of the 0.25% Senior Notes, and transaction costs attributable to the equity component were netted with the equity component in temporary stockholders' equity and stockholders' equity.

The 0.25% Senior Notes consisted of the following (in thousands):

	As of October 31, 2015	January 31, 2015
Liability component :		
Principal:		
0.25% Senior Notes (1)	$1,150,000	$1,150,000
Less: debt discount, net		
0.25% Senior Notes (2)	(61,090)	(79,308)
Net carrying amount	$1,088,910	$1,070,692

(1)The effective interest rate of the 0.25% Senior Notes is 2.53%. The interest rate is based on the interest rates of similar liabilities at the time of issuance that did not have an associated convertible feature.

(2)Included in the condensed consolidated balance sheets within Convertible 0.25% Senior Notes (which is classified as a noncurrent liability) and is amortized over the life of the 0.25% Senior Notes using the effective interest rate method.

The total estimated fair value of the Company's 0.25% Senior Notes at October 31, 2015 was $1.5 billion. The fair value was determined based on the closing trading price per $100 of the 0.25% Senior Notes as of the last day of trading for the third quarter of fiscal 2016.

Based on the closing price of the Company's common stock of $77.71 on October 30, 2015, the if-converted value of the 0.25% Senior Notes exceeded their principal amount by approximately $195.1 million. Based on the terms of the 0.25% Senior Notes, the Senior Notes were not convertible for the three months ended October 31, 2015.

Note Hedges

To minimize the impact of potential economic dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock (the "0.25% Note Hedges").

(in thousands, except for shares)	Date	Purchase	Shares
0.25% Note Hedges	March 2013	$153,800	17,308,880

The 0.25% Note Hedges cover shares of the Company's common stock at a strike price that corresponds to the initial conversion price of the 0.25% Senior Notes, also subject to adjustment, and are exercisable upon conversion of the Notes. The 0.25% Note Hedges will expire upon the maturity of the 0.25% Senior Notes. The 0.25% Note Hedges are intended to reduce the potential economic dilution upon conversion of the 0.25% Senior Notes in the event that the market value per share of the Company's common stock, as measured under the 0.25% Senior Notes, at the time of exercise is greater than the conversion price of the 0.25% Senior Notes. The 0.25% Note Hedges are separate transactions and are not part of the terms of the 0.25% Senior Notes. Holders of the 0.25% Senior Notes will not have any rights with respect to the 0.25% Note Hedges. The 0.25% Note Hedges do not impact earnings per share.

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Warrants

	Date	Proceeds (in thousands)	Shares	Strike Price
0.25% Warrants	March 2013	$84,800	17,308,880	$90.40

In March 2013, the Company also entered into a warrants transaction (the “0.25% Warrants”), whereby the Company sold warrants to acquire, subject to anti-dilution adjustments, shares of the Company’s common stock. The 0.25% Warrants were anti-dilutive for the periods presented. The 0.25% Warrants are separate transactions entered into by the Company and are not part of the terms of the 0.25% Senior Notes or the 0.25% Note Hedges. Holders of the 0.25% Senior Notes and 0.25% Note Hedges will not have any rights with respect to the 0.25% Warrants.

Revolving Credit Facility

In October 2014, the Company entered into an agreement (the “Credit Agreement”) with Wells Fargo, N.A. and certain other institutional lenders that provides for a $650.0 million unsecured revolving credit facility that matures in October 2019 (the “Credit Facility”). Immediately upon closing, the Company borrowed $300.0 million under the Credit Facility. The Borrowings under the Credit Facility bear interest, at the Company’s option at either a base rate, as defined in the Credit Agreement, plus a margin of 0.00% to 0.75% or LIBOR plus a margin of 1.00% to 1.75%. The Company is obligated to pay ongoing commitment fees at a rate between 0.125% and 0.25%. Such interest rate margins and commitment fees are based on the Company’s consolidated leverage ratio for the preceding four fiscal quarter periods. Interest and the commitment fees are payable in arrears quarterly. The Company may use amounts borrowed under the Credit Facility for working capital, capital expenditures and other general corporate purposes, including permitted acquisitions. Subject to certain conditions stated in the Credit Agreement, the Company may borrow amounts under the Credit Facility at any time during the term of the Credit Agreement. The Company may also prepay borrowings under the Credit Agreement, in whole or in part, at any time without premium or penalty, subject to certain conditions, and amounts repaid or prepaid may be reborrowed.

The Credit Agreement contains certain customary affirmative and negative covenants, including a consolidated leverage ratio covenant, a consolidated interest coverage ratio covenant, a limit on the Company’s ability to incur additional indebtedness, dispose of assets, make certain acquisition transactions, pay dividends or distributions, and certain other restrictions on the Company’s activities each defined specifically in the Credit Agreement. The Company was in compliance with the Credit Agreement’s covenants as of October 31, 2015.

In March 2015, the Company paid down $300.0 million of outstanding borrowings under the Credit Facility. There are currently no outstanding borrowings held under the Credit Facility as of October 31, 2015.

The weighted average interest rate on borrowings under the Credit Facility was 1.6% for the period beginning in October 2014 and ended March 31, 2015. The Company continues to pay a fee of 0.15% on the undrawn amount of the Credit Facility.

Loan Assumed on 50 Fremont

The Company assumed a $200.0 million loan with the acquisition of 50 Fremont (the “Loan”). The Loan bears an interest rate of 3.75% per annum and is due in June 2023. The Loan initially requires interest only payments. Beginning in fiscal year 2019, principal and interest payments are required, with the remaining principal due at maturity. For the three and nine months ended October 31, 2015, total interest expense recognized was $1.9 million and $5.4 million, respectively. The Loan can be prepaid at any time subject to a yield maintenance fee. The agreement governing the Loan contains certain customary affirmative and negative covenants that the Company was in compliance with as of October 31, 2015.

Interest Expense on Convertible Senior Notes, Revolving Credit Facility and Loan Secured by 50 Fremont

The following table sets forth total interest expense recognized related to the 0.25% Senior Notes, the Credit Facility and the Loan prior to capitalization of interest (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Contractual interest expense	$2,843	$2,190	$9,036	$7,777

Amortization of debt issuance costs	1,027	1,132	3,077	3,490
Amortization of debt discount	6,148	8,637	18,317	28,837
	$10,018	$11,959	$30,430	$40,104

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6. Other Balance Sheet Accounts

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	As of October 31, 2015	January 31, 2015
Deferred income taxes, net	$42,605	$35,528
Prepaid income taxes	23,167	21,514
Customer contract asset	3,572	16,620
Other taxes receivable	32,187	27,540
Prepaid expenses and other current assets	210,378	179,352
	$311,909	$280,554

Customer contract asset reflects future billings of amounts that are contractually committed by ExactTarget’s existing customers as of the acquisition date in July 2013 that will be billed in the next 12 months. As the Company bills these customers this balance will reduce and accounts receivable will increase.

Capitalized Software, net

Capitalized software consisted of the following (in thousands):

	As of October 31, 2015	January 31, 2015
Capitalized internal-use software development costs, net of accumulated amortization of $172,728 and $136,314, respectively	$114,058	$96,617
Acquired developed technology, net of accumulated amortization of $459,215 and $392,736, respectively	282,955	336,781
	$397,013	$433,398

Capitalized internal-use software amortization expense totaled $12.9 million and $9.5 million for the three months ended October 31, 2015 and 2014, respectively, and totaled $36.4 million and $26.2 million for the nine months ended October 31, 2015 and 2014, respectively. Acquired developed technology amortization expense totaled $22.1 million and $22.5 million for the three months ended October 31, 2015 and 2014, respectively, and totaled $66.5 million and $75.9 million for the nine months ended October 31, 2015 and 2014, respectively.

The Company capitalized $1.3 million and $1.5 million of stock-based expenses related to capitalized internal-use software development during the three months ended October 31, 2015 and 2014, respectively, and $4.4 million and $3.6 million for the nine months ended October 31, 2015 and 2014, respectively.

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Other Assets, net

Other assets consisted of the following (in thousands):

	As of October 31, 2015	January 31, 2015
Deferred income taxes, noncurrent, net	$7,236	$9,275
Long-term deposits	20,126	19,715
Purchased intangible assets, net of accumulated amortization of $191,807 and $130,968, respectively	277,898	329,971
Acquired intellectual property, net of accumulated amortization of $20,837 and $15,695, respectively	12,167	15,879
Customer contract asset	115	1,447
Other	79,185	76,259
	$396,727	$452,546

Purchased intangible assets amortization expense for the three months ended October 31, 2015 and 2014 was $20.1 million and $14.9 million, respectively and for the nine months ended October 31, 2015 and 2014 was $60.8 million and $44.9 million, respectively. Acquired intellectual property amortization expense for the three months ended October 31, 2015 and 2014 was $1.7 million and $1.2 million, respectively and for the nine months ended October 31, 2015 and 2014 was $5.1 million and $3.6 million, respectively.

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Accounts Payable, Accrued Expenses and Other Liabilities

Accounts payable, accrued expenses and other liabilities consisted of the following (in thousands):

	As of October 31, 2015	January 31, 2015
Accounts payable	$88,755	$95,537
Accrued compensation	415,958	457,102
Accrued other liabilities	424,004	321,032
Accrued income and other taxes payable	154,020	184,844
Accrued professional costs	31,234	16,889
Customer liability, current (1)	10,315	13,084
Accrued rent	13,477	14,847
Financing obligation, building in progress-leased facility, current	11,930	0
	$1,149,693	$1,103,335

(1) Customer liability reflects the legal obligation to provide future services that are contractually committed to ExactTarget’s existing customers but unbilled as of the acquisition date in July 2013. As these services are invoiced, this balance will decrease and deferred revenue will increase.

Other Noncurrent Liabilities

Other noncurrent liabilities consisted of the following (in thousands):

	As of October 31, 2015	January 31, 2015
Deferred income taxes and income taxes payable	$113,801	$94,396
Customer liability, noncurrent	81	1,026
Financing obligation, building in progress-leased facility	194,350	125,289
Long-term lease liabilities and other	569,816	701,612
	$878,048	$922,323

7. Stockholders’ Equity

The Company maintains the following stock plans: the ESPP, the 2013 Equity Incentive Plan and the 2014 Inducement Equity Incentive Plan (the “2014 Inducement Plan”). The expiration of the 1999 Stock Option Plan (“1999 Plan”) in fiscal 2010 did not affect awards outstanding, which continue to be governed by the terms and conditions of the 1999 Plan. Offerings under the ESPP commenced in December 2011.

As of October 31, 2015, $74.4 million has been withheld on behalf of employees for future purchases under the ESPP and is recorded in accounts payable, accrued expenses and other liabilities.

Prior to February 1, 2006, options issued under the Company’s stock option plans generally had a term of 10 years. From February 1, 2006 through July 2013, options issued had a term of five years. After July 2013, options issued have a term of seven years.

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Stock activity excluding the ESPP is as follows:

	Shares Available for Grant	Options Outstanding		
		Outstanding Stock Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Balance as of January 31, 2015	30,789,538	29,458,361	$44.36	
Increase in shares authorized:				
2013 Equity Incentive Plan	38,833,915	0	0.00	
2014 Inducement Equity Incentive Plan	222,281	0	0.00	
Options granted under all plans	(1,243,913)	1,243,913	70.06	
Restricted stock activity	(1,717,493)	0	0.00	
Stock grants to board and advisory board members	(147,305)	0	0.00	
Exercised	0	(7,139,738)	34.67	
Plan shares expired	(1,533,380)	0	0.00	
Canceled	1,623,954	(1,623,954)	46.33	
Balance as of October 31, 2015	66,827,597	21,938,582	$48.82	$633,719,094
Vested or expected to vest		20,636,830	$48.30	$606,931,261
Exercisable as of October 31, 2015		7,999,144	$37.53	$321,427,698

The total intrinsic value of the options exercised during the nine months ended October 31, 2015 and 2014 was $251.3 million and $202.0 million, respectively. The intrinsic value is the difference between the current market value of the stock and the exercise price of the stock option.

The weighted-average remaining contractual life of vested and expected to vest options is approximately 4.5 years.

As of October 31, 2015, options to purchase 7,999,144 shares were vested at a weighted average exercise price of $37.53 per share and had a remaining weighted-average contractual life of approximately 2.9 years. The total intrinsic value of these vested options as of October 31, 2015 was $321.4 million.

The following table summarizes information about stock options outstanding as of October 31, 2015:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
$0.86 to $29.38	3,115,316	2.3	$24.20	2,756,842	$24.42
$29.67 to $39.09	4,239,789	2.1	37.94	2,856,120	37.86
$40.19 to $52.14	567,287	4.3	43.27	212,321	43.57
$52.30	4,107,344	5.1	52.30	1,693,467	52.30
$53.60 to $57.79	1,572,567	5.6	55.24	424,396	55.15
$59.34	6,561,546	6.1	59.34	0	0.00
$59.37 to $77.37	1,774,733	6.3	67.22	55,998	62.64
	21,938,582	4.5	$48.82	7,999,144	$37.53

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Restricted stock activity is as follows:

	Restricted Stock Outstanding		
	Outstanding	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2015	23,144,008	$0.001	
Granted	2,714,178	0.001	
Canceled	(2,296,785)	0.001	
Vested and converted to shares	(6,052,630)	0.001	
Balance as of October 31, 2015	17,508,771	$0.001	$1,360,607
Expected to vest	15,326,839		$1,191,049

The restricted stock, which upon vesting entitles the holder to one share of common stock for each share of restricted stock, has an exercise price of $0.001 per share, which is equal to the par value of the Company's common stock, and generally vests over 4 years.

The weighted-average grant date fair value of the restricted stock issued for the nine months ended October 31, 2015 and 2014 was $70.26 and $58.84, respectively.

Common Stock

The following number of shares of common stock were reserved and available for future issuance at October 31, 2015:

Options outstanding	21,938,582
Restricted stock awards and units outstanding	17,508,771
Stock available for future grant:	
2013 Equity Incentive Plan	66,132,255
2014 Inducement Equity Incentive Plan	695,342
Amended and Restated 2004 Employee Stock Purchase Plan	8,259,824
Convertible Senior Notes	17,308,880
Warrants	17,308,880
	149,152,534

8. Income Taxes

Effective Tax Rate

The Company computes its year-to-date provision for income taxes by applying the estimated annual effective tax rate to year to date pretax income or loss and adjusts the provision for discrete tax items recorded in the period. For the nine months ended October 31, 2015, the Company reported a tax provision of $90.3 million on a pretax income of $68.4 million, which resulted in an effective tax rate of 132 percent. The tax provision recorded was related to income taxes in profitable jurisdictions outside of the United States and the current tax expense in the United States. The Company had U.S. current tax expense as a result of forecasted taxable income before considering certain excess tax benefits from stock options and vesting of restricted stock.

The U.S. Tax Court ("Tax Court") recently issued an opinion favorable to Altera Corporation ("Altera") with respect to Altera's litigation with the Internal Revenue Service ("IRS"). The litigation relates to the treatment of stock-based compensation expense in an inter-company cost-sharing arrangement with Altera's foreign subsidiary. In its opinion, the Tax Court accepted Altera's position of excluding stock-based compensation from its inter-company cost-sharing arrangement. Once the final decision is issued by the Tax Court, the IRS could still appeal such decision; as a result, the Company will continue to monitor this matter and the related potential impacts to its financial statements. During the quarter ended October 31, 2015, the Company amended its inter-company cost-sharing arrangement to exclude stock-based compensation expense beginning in fiscal 2016 and accordingly, the Company recognized the related tax impact through its year-to-date tax provision.

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For the nine months ended October 31, 2014, the Company reported a tax provision of $37.3 million on a pretax loss of $159.6 million, which resulted in a negative effective tax rate of 23 percent. The tax provision recorded was primarily related to income taxes in profitable jurisdictions outside the United States.

Tax Benefits Related to Stock-Based Compensation

The total income tax benefit related to stock-based awards was $130.8 million and $125.7 million for nine months ended October 31, 2015 and 2014, respectively, the majority of which was not recognized as a result of the valuation allowance.

Unrecognized Tax Benefits and Other Considerations

The Company records liabilities related to its uncertain tax positions. Tax positions for the Company and its subsidiaries are subject to income tax audits by multiple tax jurisdictions throughout the world. Certain prior year tax returns are currently being examined by various taxing authorities in countries including the United States, Germany, Switzerland and the United Kingdom. To date, the Company has not received any proposed adjustments that would result in a material impact to its income tax provision.

The Company believes that it has provided adequate reserves for its income tax uncertainties in all open tax years. However, the outcome of the tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner inconsistent with management's expectations, the Company could adjust its provision for income taxes in the future. Based on the information to-date, as some of the ongoing examinations are completed and tax positions in these tax years meet the conditions of being effectively settled, the Company anticipates it is reasonably possible that a decrease of unrecognized tax benefits up to approximately $32.0 million may occur in the next 12 months.

9. Earnings/Loss Per Share

Basic earnings/loss per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the fiscal period. Diluted earnings/loss per share is computed by giving effect to all potential weighted average dilutive common stock, including options, restricted stock units, warrants and the convertible senior notes. The dilutive effect of outstanding awards and convertible securities is reflected in diluted earnings per share by application of the treasury stock method. Diluted loss per share for the three and nine months ended October 31, 2015 and 2014 is the same as basic loss per share as there is a net loss in the period and inclusion of potentially issuable shares is anti-dilutive.

A reconciliation of the denominator used in the calculation of basic and diluted earnings/(loss) per share is as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Numerator:				
Net loss	$(25,157)	$(38,924)	$(21,917)	$(196,923)
Denominator:				
Weighted-average shares outstanding for basic loss per share	664,131	629,548	659,160	619,748
Effect of dilutive securities:				
Convertible senior notes	0	0	0	0
Employee stock awards	0	0	0	0
Warrants	0	0	0	0
Adjusted weighted-average shares outstanding and assumed conversions for diluted loss per share	664,131	629,548	659,160	619,748

The weighted-average number of shares outstanding used in the computation of diluted earnings/loss per share does not include the effect of the following potential outstanding common stock. The effects of these potentially outstanding shares were not included in the calculation of diluted earnings/loss per share because the effect would have been anti-dilutive (in thousands):

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	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Stock awards	20,191	19,922	22,634	20,115
Convertible senior notes	17,309	25,820	17,309	28,834
Warrants	17,309	44,253	17,309	44,253

10. Commitments

Letters of Credit

As of October 31, 2015, the Company had a total of $70.4 million in letters of credit outstanding substantially in favor of certain landlords for office space. These letters of credit renew annually and expire at various dates through December 2030.

Leases

The Company leases facilities space and certain fixed assets under non-cancelable operating and capital leases with various expiration dates.

As of October 31, 2015, the future minimum lease payments under non-cancelable operating and capital leases are as follows (in thousands):

	Capital Leases	Operating Leases	Financing Obligation, Building in Progress-Leased Facility(1)
Fiscal Period:			
Remaining three months of fiscal 2016	$16,437	$87,285	$1,434
Fiscal 2017	116,792	347,232	16,877
Fiscal 2018	121,012	311,403	21,107
Fiscal 2019	114,085	241,180	21,551
Fiscal 2020	201,507	213,419	21,995
Thereafter	0	1,344,224	252,517
Total minimum lease payments	569,833	$2,544,743	$335,481
Less: amount representing interest	(61,973)		
Present value of capital lease obligations	$507,860		

(1) Total Financing Obligation, Building in Progress-Leased Facility noted above represents the total obligation on the lease agreement including amounts allocated to interest noted in Note 3 “Property and Equipment.” As of October 31, 2015, $206.3 million of the total obligation noted above was recorded to Financing obligation, building in progress - leased facility, of which the current portion is included in "Accounts payable, accrued expenses, and other liabilities" and the non-current portion is included in “Other noncurrent liabilities” on the condensed consolidated balance sheets.

The Company’s agreements for the facilities and certain services provide the Company with the option to renew. The Company’s future contractual obligations would change if the Company exercised these options.

The terms of the lease agreements provide for rental payments on a graduated basis. The Company recognizes rent expense on a straight-line basis over the lease period and has accrued for rent expense incurred but not paid. Of the total operating lease commitment and financing obligation, building in progress- leased facility balance of $2.9 billion, approximately $1.9 billion is related to facilities space. The remaining commitment amount is related to computer equipment, other leases, data center capacity and our development and test data center.

11. Legal Proceedings and Claims

In the ordinary course of business, the Company is or may be involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, corporate and securities, labor and employment, class actions, wage and hour, and other claims. The Company has 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.

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In July 2015, the Company and certain of its current and former directors were named as defendants in a purported shareholder derivative action in the Superior Court for the State of California, County of San Francisco. The plaintiff filed an amended version of this derivative complaint in November 2015. The derivative complaint alleges that excessive compensation was paid to such directors for their service. The derivative complaint includes allegations of breach of fiduciary duty and unjust enrichment and seeks restitution and disgorgement of a portion of the directors' compensation, as well as reform of a Company equity plan. Because the complaint is derivative in nature, it does not seek monetary damages from the Company.

During fiscal 2015, the Company received a communication from a large technology company alleging that the Company infringed certain of its patents. The Company continues to analyze this claim. No litigation has been filed to date. There can be no assurance that this claim will not lead to litigation in the future. The resolution of this claim is not expected to have a material adverse effect on the Company's financial condition, but it could be material to the net income or cash flows or both of a particular quarter.

In general, the resolution of a legal matter could prevent the Company from offering its service to others, could be material to the Company’s financial condition or cash flows, or both, or could otherwise adversely affect the Company’s operating results.

The Company makes 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, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In management’s opinion, resolution of all current matters is not expected to have a material adverse impact on the Company’s 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 the Company’s future results of operations or cash flows, or both, of a particular quarter.

12. Related-Party Transactions

In January 1999, the Salesforce.com Foundation, also referred to as the Foundation, was chartered on an idea of leveraging the Company’s people, technology, and resources to help improve communities around the world. The Company calls this integrated philanthropic approach the 1-1-1 model. Beginning in 2008, Salesforce.org, which is a non-profit mutual benefit corporation, was established to resell the Company's services to nonprofit organizations and certain higher education organizations.

The Company’s chairman is the chairman of both the Foundation and Salesforce.org. The Company’s chairman holds one of the three Foundation board seats. The Company’s chairman, one of the Company’s employees and one of the Company’s board members hold three of Salesforce.org’s ten board seats. The Company does not control the Foundation’s or Salesforce.org's activities, and accordingly, the Company does not consolidate either of the related entities' statement of activities with its financial results.

Since the Foundation’s and Salesforce.org’s inception, the Company has provided at no charge certain resources to those entities employees such as office space, furniture, equipment, facilities, services, and other resources. The value of these items was approximately $0.9 million for the nine months ended October 31, 2015.

The resource sharing agreement was amended in August 2015 to include resources outside of the United States and is more explicit about the types of resources that the Company will provide.

Additionally, the Company has donated subscriptions of the Company’s services to other qualified non-profit organizations. The Company also allows Salesforce.org to resell the Company’s service to non-profit organizations and certain education entities. The Company does not charge Salesforce.org for these subscriptions, therefore revenue from subscriptions provided to non-profit organizations is donated back to the community through charitable grants made by the Foundation and Salesforce.org. The reseller agreement was amended in August 2015 to include additional customer segments and certain customers outside the U.S. and in October 2015 to add an addendum with model clauses for the processing of personal data transferred from the European Economic Area. The value of the subscriptions pursuant to reseller agreements was approximately $48.2 million for the nine months ended October 31,

2015. The Company plans to continue these programs.

The Company has committed to donate $4.0 million to the Foundation to further support its philanthropic mission. This amount will be paid to the Foundation during this fiscal year.

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

This Quarterly Report on form 10-Q, including the following discussion in"Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Words such as "expects," "anticipates," "aims," "projects," "intends "plans," "believes," "estimates," "seeks," "assumes," "may," "should," "could," "foresees," "forecasts," "predicts," variations o and similar expressions are intended to identify such forward-looking statements, which may consist of, among other things, trend analyses and statements regarding future events, future financial performance, anticipated growth and industry prospects. These forward-looking statements are based on current expectations, estimates and forecasts, as well as the beliefs and assumptions of our management, and are subject to risks and uncertainties that are difficult to predict, including the effect of general economic and market conditions; the impact of foreign currency exchange rate and interest rate fluctuations on our results; our business strategy and our plan to build our business, including our strategy to be the leading provider of enterprise cloud computing applications and platforms; our service performance and security; the expenses associated with new data centers; additional data center capacity; real estate and office facilities space; our operating results; new services and product features; our strategy of acquiring or making investments in complementary businesses, joint ventures, services, technologies and intellectual property rights; our ability to successfully integrate acquired businesses and technologies; our ability to continue to grow and maintain deferred revenue and unbilled deferred revenue; our ability to protect our intellectual property rights; our ability to develop our brands; our ability to realize the benefits from strategic partnerships and investments; our reliance on third- party hardware, software and platform providers; the effect of evolving government regulations; the valuation of our deferred tax assets; the potential availability of additional tax assets in the future; the impact of expensing stock options and other equity awards; the sufficiency of our capital resources; factors related to our outstanding convertible notes, revolving credit facility and loan associated with 50 Fremont; compliance with our debt covenants and capital lease obligations; and current and potential litigation involving us. These and other risks and uncertainties may cause our actual results to differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified below under "Risk Factors" and elsewhere in this report for additional detail regarding factors that may cause actual results to be different than those expressed in our forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Overview

We are a leading provider of enterprise cloud computing solutions, with a focus on customer relationship management, or CRM. We introduced our first CRM solution in February 2000 and we have since expanded our offerings with new editions, solutions, enhanced features, platform capabilities and a new analytics solution through internal development and acquisitions. We sell to businesses of all sizes and in almost every industry worldwide on a subscription basis.

Our mission is to help our customers transform themselves into "customer companies" by empowering them to connect with their customers in entirely new ways. With our six primary core cloud service offerings—Sales Cloud, Service Cloud, Marketing Cloud, Communities Cloud, Analytics Cloud and App Cloud (formerly Salesforce1 Platform) —customers have the tools they need to build a next generation customer success platform. Key elements of our strategy include:

- strengthening our market-leading solutions;
- extending distribution into new and high-growth categories;
- expanding strategic relationships with our existing customers;
- pursuing new customers;
- reducing customer attrition;
- building our business in top software markets globally, which includes building partnerships that help add customers; and

- encouraging the development of third-party applications on our cloud computing platforms.

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We believe the factors that will influence our ability to achieve our objectives include: our prospective customers' willingness to migrate to enterprise cloud computing services; the availability, performance and security of our service; our ability to continue to release, and gain customer acceptance of, new and improved features; our ability to successfully integrate acquired businesses and technologies; successful customer adoption and utilization of our service; acceptance of our service in markets where we have few customers; the emergence of additional competitors in our market and improved product offerings by existing and new competitors; the location of new data centers; third-party developers' willingness to develop applications on our platforms; our ability to attract new personnel and retain and motivate current personnel; evolving domestic and foreign privacy and data transfer concerns, restrictions and laws; and general economic conditions which could affect our customers' ability and willingness to purchase our services, delay the customers' purchasing decision or affect attrition rates.

To address these factors, we will need to, among other things, continue to add substantial numbers of paying subscriptions, upgrade our customers to fully featured versions or arrangements such as an Enterprise License Agreement, provide high quality technical support to our customers, encourage the development of third-party applications on our platforms and continue to focus on retaining customers at the time of renewal. Our plans to invest for future growth include the continuation of the expansion of our data center capacity, the hiring of additional personnel, particularly in direct sales, other customer-related areas and research and development, the expansion of domestic and international selling and marketing activities, specifically in our top markets, continuing to develop our brands, the addition of distribution channels, the upgrade of our service offerings, the development of new services such as the Analytics, Communities and Internet of Things Clouds, the integration of acquired technologies, the expansion of our Marketing Cloud and App Cloud core service offerings, and the additions to our global infrastructure to support our growth.

We also regularly evaluate acquisitions or investment opportunities in complementary businesses, joint ventures, services and technologies and intellectual property rights in an effort to expand our service offerings. We expect to continue to make such investments and acquisitions in the future and we plan to reinvest a significant portion of our incremental revenue in future periods to grow our business and continue our leadership role in the cloud computing industry. As a result of our aggressive growth plans, specifically our hiring plan and acquisition activities, we have incurred significant expenses from equity awards and amortization of purchased intangibles which have resulted in quarterly net losses on a U.S. generally accepted accounting principles ("GAAP") basis. As we continue with our growth plan and absent any one-time gains, we may continue to have net losses on a GAAP basis.

Our typical subscription contract term is 12 to 36 months, although terms range from one to 60 months, so during any fiscal reporting period only a subset of active subscription contracts is eligible for renewal. We calculate our attrition rate as of the end of each month. Our current attrition rate calculation does not include the Marketing Cloud service offerings. Our attrition rate was approximately nine percent as of October 31, 2015. We expect our attrition rate to remain consistent as we continue to expand our enterprise business and invest in customer success and related programs.

We expect marketing and sales costs, which were 48 percent and 52 percent of our total revenues for the three months ended October 31, 2015 and 2014, respectively and 49 percent and 51 percent for the nine months ended October 31, 2015 and 2014, respectively, to continue to represent a substantial portion of total revenues in the future as we seek to grow our customer base, sell more products to existing customers, and build greater brand awareness.

In February 2015, we purchased a 41-story office building in San Francisco, California which we refer to as 50 Fremont. As part of the business combination accounting for the purchase, we recognized a one-time non-cash net gain of $36.6 million during the three months ended April 30, 2015 for the termination of the operating leases that existed prior to the purchase. As described within "Non-GAAP Financial Measures" the one-time non-cash net gain of $36.6 million has been deducted from our GAAP net income (loss) to arrive to our Non-GAAP net income.

In October 2015, we sold approximately 8.8 net acres of undeveloped real estate and the associated perpetual parking rights in San Francisco, California, which were classified as held for sale. The total proceeds from the sale were $157.1 million, of which we received $127.1 million during the three months ended October 31, 2015 and previously received a nonrefundable deposit in the amount of $30.0 million during the three months ended April 30, 2014. We recognized a gain of $21.8 million, net of closing costs, on the sale of this portion of our land and building

improvements and perpetual parking rights.

During the nine months ended October 31, 2015, we increased our strategic investments portfolio by $337.8 million. These investments were in privately held companies, including some development stage companies. We plan to continue to make strategic investments in the future.

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Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2016, for example, refer to the fiscal year ending January 31, 2016.

Operating Segments

We operate as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, who in our case is the chief executive officer, in deciding how to allocate resources and assess performance. Over the past few years, we have completed several acquisitions. These acquisitions have allowed us to expand our offerings, presence and reach in various market segments of the enterprise cloud computing market. While we have offerings in multiple enterprise cloud computing market segments, our business operates in one operating segment because all of our offerings operate on a single platform and are deployed in an identical way, and our chief operating decision maker evaluates our financial information and resources and assesses the performance of these resources on a consolidated basis. Since we operate as one operating segment, all required financial segment information can be found in the condensed consolidated financial statements.

Sources of Revenues

We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers paying for additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue. “Other revenue” consists primarily of training fees. Subscription and support revenues accounted for approximately 93 percent of our total revenues for the nine months ended October 31, 2015. Subscription revenues are driven primarily by the number of paying subscribers, varying service types, the price of our service and renewals. We define a “customer” as a separate and distinct buying entity (e.g., a company, a distinct business unit of a large corporation, a partnership, etc.) that has entered into a contract to access our enterprise cloud computing services. We define a “subscription” as a unique user account purchased by a customer for use by its employees or other customer-authorized users, and we refer to each such user as a “subscriber.” The number of paying subscriptions at each of our customers ranges from one to hundreds of thousands. None of our customers accounted for more than five percent of our revenues during the nine months ended October 31, 2015 and 2014.

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement dates of each contract. The typical subscription and support term is 12 to 36 months, although terms range from one to 60 months. Our subscription and support contracts are non-cancelable, though customers typically have the right to terminate their contracts for cause if we materially fail to perform. We generally invoice our customers in advance, in annual installments, and typical payment terms provide that our customers pay us within 30 days of invoice. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue, or in revenue depending on whether the revenue recognition criteria have been met. In general, we collect our billings in advance of the subscription service period.

Professional services and other revenues consist of fees associated with consulting and implementation services and training. Our consulting and implementation engagements are typically billed on a time and materials basis. We also offer a number of training classes on implementing, using and administering our service that are billed on a per person, per class basis. Our typical professional services payment terms provide that our customers pay us within 30 days of invoice.

In determining whether professional services can be accounted for separately from subscription and support revenues, we consider a number of factors, which are described in “Critical Accounting Estimates—Revenue Recognition” below.

Revenue by Cloud Service Offering

We are providing the information below on a supplemental basis to give additional insight into the revenue performance of our individual core service offerings.

Subscription and support revenues consisted of the following by core service offering (in millions):

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	Three Months Ended October 31,			Nine Months Ended October 31,		
	2015	2014	Variance-Percent	2015	2014	Variance-Percent
Sales Cloud	$688.7	$625.0	10%	$1,990.1	$1,811.7	10%
Service Cloud	469.5	339.6	38%	1,322.4	953.1	39%
App Cloud and Other	269.1	192.4	40%	740.4	538.7	37%
Marketing Cloud	169.0	131.5	29%	470.1	364.9	29%
Total	$1,596.3	$1,288.5		$4,523.0	$3,668.4	

Subscription and support revenues from Analytics Cloud and Communities Cloud, which were introduced in October 2014, were not significant for the three and nine months ended October 31, 2015. The Analytics Cloud revenue is included with App Cloud and Other in the table above. Communities Cloud revenue is included in either Sales Cloud, Service Cloud or App Cloud and Other revenue depending on the primary service offering purchased.

In situations where a customer purchases multiple cloud offerings, such as through an Enterprise License Agreement, we allocate the contract value to each core service offering based on the customer's estimated product demand plan and the service that was provided at the inception of the contract. We do not update these allocations based on actual product usage during the term of the contract. We have allocated approximately 10 percent of our total subscription and support revenues for the three and nine months ended October 31, 2015 and 2014, based on customers' estimated product demand plans and these allocated amounts are included in the table above.

Additionally, some of our core service offerings have similar features and functions. For example, customers may use the Sales Cloud, the Service Cloud or our App Cloud to record account and contact information, which are similar features across these core service offerings. Depending on a customer's actual and projected business requirements, more than one core service offering may satisfy the customer's current and future needs. We record revenue based on the individual products ordered by a customer, and not according to the customer's business requirements and usage. In addition, as we introduce new features and functions within each offering, and refine our allocation methodology for changes in our business, we do not expect it to be practical to adjust historical revenue results by core service offering for comparability. Accordingly, comparisons of revenue performance by core service offering over time may not be meaningful.

Our Sales Cloud service offering is our most widely distributed service offering and has historically been the largest contributor of subscription and support revenues. We estimate that for the remainder of fiscal 2016, subscription and support revenues from the Sales Cloud service offering will continue to be the largest contributor of subscription and support revenue.

Seasonal Nature of Deferred Revenue, Accounts Receivable and Operating Cash Flow

Deferred revenue primarily consists of billings to customers for our subscription service. Over 90 percent of the value of our billings to customers is for our subscription and support service. We generally invoice our customers in annual cycles. Approximately 79 percent of the value of all subscription and support related invoices were issued with annual terms during the three months ended October 31, 2015 in comparison to 73 percent during the same period a year ago. Occasionally, we bill customers for their multi-year contract on a single invoice which results in an increase in noncurrent deferred revenue. We typically issue renewal invoices in advance of the renewal service period, and depending on timing, the initial invoice for the subscription and services contract and the subsequent renewal invoice may occur in different quarters. This may result in an increase in deferred revenue and accounts receivable. There is a disproportionate weighting towards annual billings in the fourth quarter, primarily as a result of large enterprise account buying patterns. Our fourth quarter has historically been our strongest quarter for new business and renewals. The year on year compounding effect of this seasonality in both billing patterns and overall new and renewal business causes the value of invoices that we generate in the fourth quarter for both new business and renewals to increase as a proportion of our total annual billings. Accordingly, because of this billing activity, our first quarter is historically our largest collections and operating cash flow quarter.

The sequential quarterly changes in accounts receivable and the related deferred revenue and operating cash flow during the first quarter of our fiscal year are not necessarily indicative of the billing activity that occurs for the

following quarters as

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displayed below (in thousands, except unbilled deferred revenue):

		April 30, 2015	July 31, 2015	October 31, 2015
Fiscal 2016				
Accounts receivable, net		$926,381	$1,067,799	$1,060,726
Deferred revenue, current and noncurrent		3,056,820	3,034,991	2,846,510
Operating cash flow (1)		730,857	304,411	117,907
Unbilled deferred revenue, a non-GAAP measure		6.0 bn	6.2 bn	6.7 bn

	April 30, 2014	July 31, 2014	October 31, 2014	January 31, 2015
Fiscal 2015				
Accounts receivable, net	$684,155	$834,323	$794,590	$1,905,506
Deferred revenue, current and noncurrent	2,324,615	2,352,904	2,223,977	3,321,449
Operating cash flow (1)	473,087	245,893	122,511	332,223
Unbilled deferred revenue, a non-GAAP measure	4.8 bn	5.0 bn	5.4 bn	5.7 bn

	April 30, 2013	July 31, 2013	October 31, 2013	January 31, 2014
Fiscal 2014				
Accounts receivable, net	$502,609	$599,543	$604,045	$1,360,837
Deferred revenue, current and noncurrent	1,733,160	1,789,648	1,734,619	2,522,115
Operating cash flow (1)	283,189	183,183	137,859	271,238
Unbilled deferred revenue, a non-GAAP measure	3.6 bn	3.8 bn	4.2 bn	4.5 bn

(1) Operating cash flow represents net cash provided by operating activities for the three months ended in the periods stated above.

Unbilled Deferred Revenue, a Non-GAAP Measure

The deferred revenue balance on our condensed consolidated balance sheets does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Unbilled deferred revenue represents future billings under our subscription agreements that have not been invoiced and, accordingly, are not recorded in deferred revenue. Unbilled deferred revenue was approximately $6.7 billion as of October 31, 2015 and approximately $5.7 billion as of January 31, 2015. Our typical contract length is between 12 and 36 months. We expect that the amount of unbilled deferred revenue will change from quarter to quarter for several reasons, including the specific timing, duration and size of large customer subscription agreements, varying billing cycles of subscription agreements, the specific timing of customer renewals, foreign currency fluctuations, the timing of when unbilled deferred revenue is to be recognized as revenue, and changes in customer financial circumstances. For multi-year subscription agreements billed annually, the associated unbilled deferred revenue is typically high at the beginning of the contract period, zero just prior to renewal, and increases if the agreement is renewed. Low unbilled deferred revenue attributable to a particular subscription agreement is often associated with an impending renewal and may not be an indicator of the likelihood of renewal or future revenue from such customer. Accordingly, we expect that the amount of aggregate unbilled deferred revenue will change from year-to-year depending in part upon the number and dollar amount of subscription agreements at particular stages in their renewal cycle. Such fluctuations are not a reliable indicator of future revenues. Unbilled deferred revenue does not include minimum revenue commitments from indirect sales channels, as we recognize revenue, deferred revenue, and any unbilled deferred revenue upon sell-through to an end user customer.

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Cost of Revenues and Operating Expenses

Cost of Revenues. Cost of subscription and support revenues primarily consists of expenses related to hosting our service and providing support, the costs of data center capacity, depreciation or operating lease expense associated with computer equipment and software, allocated overhead, amortization expense associated with capitalized software related to our services and acquired developed technologies and certain fees paid to various third parties for the use of their technology, services and data. We allocate overhead such as information technology infrastructure, rent and occupancy charges based on headcount. Employee benefit costs and taxes are allocated based upon a percentage of total compensation expense. As such, general overhead expenses are reflected in each cost of revenue and operating expense category. Cost of professional services and other revenues consists primarily of employee-related costs associated with these services, including stock-based expenses, the cost of subcontractors and allocated overhead. The cost of providing professional services is significantly higher as a percentage of the related revenue than for our enterprise cloud computing subscription service due to the direct labor costs and costs of subcontractors.

We intend to continue to invest additional resources in our enterprise cloud computing services. For example, we have invested in additional database software and we plan to open additional data centers and expand our current data center capacity in the future. As we acquire new businesses and technologies, the amortization expense associated with this activity will be included in cost of revenues. Additionally, as we enter into new contracts with third parties for the use of their technology, services or data, or as our sales volume grows, the fees paid to use such technology or services may increase. The timing of these additional expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues, in the affected periods.

Research and Development. Research and development expenses consist primarily of salaries and related expenses, including stock-based expenses, the costs of our development and test data center and allocated overhead. We continue to focus our research and development efforts on adding new features and services, integrating acquired technologies, increasing the functionality and security and enhancing the ease of use of our enterprise cloud computing services. Our proprietary, scalable and secure multi-tenant architecture enables us to provide all of our customers with a service based on a single version of our application. As a result, we do not have to maintain multiple versions, which enables us to have relatively lower research and development expenses as compared to traditional enterprise software companies.

We expect that in the future, research and development expenses will increase in absolute dollars and may increase as a percentage of total revenues as we invest in building the necessary employee and system infrastructure required to support the development of new, and improve existing, technologies and the integration of acquired businesses and technologies.

Marketing and Sales. Marketing and sales expenses are our largest cost and consist primarily of salaries and related expenses, including stock-based expenses, for our sales and marketing staff, including commissions, payments to partners, marketing programs and allocated overhead. Marketing programs consist of advertising, events, corporate communications, brand building and product marketing activities.

We plan to continue to invest in marketing and sales by expanding our domestic and international selling and marketing activities, building brand awareness, attracting new customers and sponsoring additional marketing events. The timing of these marketing events, such as our annual and largest event, Dreamforce, will affect our marketing costs in a particular quarter. We expect that in the future, marketing and sales expenses will increase in absolute dollars and continue to be our largest cost.

General and Administrative. General and administrative expenses consist of salaries and related expenses, including stock-based expenses, for finance and accounting, legal, internal audit, human resources and management information systems personnel, legal costs, professional fees, other corporate expenses and allocated overhead. We expect that in the future, general and administrative expenses will increase in absolute dollars as we invest in our infrastructure and we incur additional employee related costs, professional fees and insurance costs related to the growth of our business and international expansion. We expect general and administrative costs as a percentage of total revenues to either remain flat or decrease for the next several quarters.

Stock-Based Expenses. Our cost of revenues and operating expenses include stock-based expenses related to equity plans for employees and non-employee directors. We recognize our stock-based compensation as an expense in the

statement of operations based on their fair values and vesting periods. These charges have been significant in the past and we expect that they will increase as our stock price increases, as we acquire more companies, as we hire more employees and seek to retain existing employees.

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During the nine months ended October 31, 2015, we recognized stock-based expense of $434.7 million. As of October 31, 2015, the aggregate stock compensation remaining to be amortized to costs and expenses over a weighted-average period of 2.5 years was $1.1 billion. We expect this stock compensation balance to be amortized as follows: $133.2 million during the remaining three months of fiscal 2016; $437.5 million during fiscal 2017; $314.9 million during fiscal 2018; $171.0 million during fiscal 2019 and $19.6 million during fiscal 2020. The expected amortization reflects only outstanding stock awards as of October 31, 2015 and assumes no forfeiture activity. We expect to continue to issue stock-based awards to our employees in future periods.

Amortization of Purchased Intangibles from Business Combinations and the Purchase of 50 Fremont. Our cost of revenues, operating expenses and other expense include amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company's research and development efforts, trade names, customer lists, acquired leases and customer relationships. We expect this expense to increase as we acquire more businesses.

Critical Accounting Estimates

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make 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.

We believe that of our significant accounting policies, which are described in the Notes to the accompanying condensed consolidated financial statements, the following accounting estimates involve a greater degree of judgment and complexity. Accordingly, these are the estimates we believe are the most critical to aid in fully understanding and evaluating our condensed consolidated financial condition and results of operations.

Revenue Recognition. We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) related professional services such as process mapping, project management, implementation services and other revenue. "Other revenue" consists primarily of training fees.

We commence revenue recognition when all of the following conditions are satisfied:

- there is persuasive evidence of an arrangement;
- the service has been or is being provided to the customer;
- the collection of the fees is reasonably assured; and
- the amount of fees to be paid by the customer is fixed or determinable.

Our subscription service arrangements are non-cancelable and do not contain refund-type provisions.

Subscription and Support Revenues

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement date of each contract, which is the date our service is made available to customers. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Professional Services and Other Revenues

The majority of our professional services contracts are on a time and material basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized after the services are performed.

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Multiple Deliverable Arrangements

We enter into arrangements with multiple deliverables that generally include multiple subscriptions, premium support, and professional services. If the deliverables have standalone value upon delivery, we account for each deliverable separately. Subscription services have standalone value as such services are often sold separately. In determining whether professional services have standalone value, we consider the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date, and the contractual dependence of the subscription service on the customer's satisfaction with the professional services work. To date, we have concluded that all of the professional services included in multiple deliverable arrangements executed have standalone value.

Multiple deliverables included in an arrangement are separated into different units of accounting and the arrangement consideration is allocated to the identified separate units based on a relative selling price hierarchy. We determine the relative selling price for a deliverable based on its vendor-specific objective evidence of selling price ("VSOE"), if available, or our best estimate of selling price ("BESP"), if VSOE is not available. We have determined that third-party evidence ("TPE") is not a practical alternative due to differences in our service offerings compared to other parties and the availability of relevant third-party pricing information. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

For certain professional services, we have established VSOE as a consistent number of standalone sales of this deliverable have been priced within a reasonably narrow range. We have not established VSOE for our subscription services due to lack of pricing consistency, the introduction of new services and other factors. Accordingly, we use our BESP to determine the relative selling price of our subscription services.

We determined BESP by considering our overall pricing objectives and market conditions. Significant pricing practices taken into consideration include our discounting practices, the size and volume of our transactions, the customer demographic, the geographic area where our services are sold, our price lists, our go-to-market strategy, historical standalone sales and contract prices. The determination of BESP is made through consultation with and approval by management, taking into consideration the go-to-market strategy. As our go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BESP.

Deferred Revenue. The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription service described above and is recognized as the revenue recognition criteria are met. We generally invoice customers in annual installments. The deferred revenue balance is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing, size and new business linearity within the quarter.

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

Deferred Commissions. We defer commission payments to our direct sales force. The commissions are deferred and amortized to sales expense over the non-cancelable terms of the related subscription contracts with our customers, which are typically 12 to 36 months. The commission payments, which are paid in full the month after the customer's service commences, are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. We believe this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the same period that the subscription revenue is recognized.

During the nine months ended October 31, 2015, we deferred $200.9 million of commission expenditures and we amortized $232.8 million to sales expense. During the same period a year ago, we deferred $171.0 million of commission expenditures and we amortized $186.5 million to sales expense. Deferred commissions on our condensed consolidated balance sheets totaled $356.3 million at October 31, 2015 and $388.2 million at January 31, 2015.

Long- Lived Assets and Impairment Assessment. We evaluate long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. This includes but is not limited to significant adverse changes in business climate, market conditions, or other events that indicate an asset's carrying amount may not be recoverable. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value.

Capitalized Internal-Use Software Costs. We are required to follow the guidance of Accounting Standards Codification 350 (“ASC 350”), Intangibles- Goodwill and Other in accounting for the cost of computer software developed for internal-

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use and the accounting for web-based product development costs. ASC 350 requires companies to capitalize qualifying computer software costs, which are incurred during the application development stage, and amortize these costs on a straight-line basis over the estimated useful life of the respective asset. We deliver our enterprise cloud computing solutions as a service via all the major Internet browsers and on leading major mobile device operating systems. As a result of this software as a service delivery model, we believe we have larger capitalized costs as compared to traditional enterprise software companies as they are required to use a different accounting standard. Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its estimated useful life. We evaluate the useful lives of these assets on an annual basis and test for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

Goodwill, Intangibles and Impairment Assessments. We make estimates, assumptions, and judgments when valuing goodwill and other intangible assets in connection with the initial purchase price allocation of an acquired entity, as well as when evaluating the recoverability of our goodwill and other intangible assets on an ongoing basis. These estimates are based upon a number of factors, including historical experience, market conditions, and information obtained from the management of acquired companies. Critical estimates in valuing certain intangible assets include, but are not limited to, historical and projected attrition rates, discount rates, anticipated growth in revenue from the acquired customers and acquired technology, and the expected use of the acquired assets. These factors are also considered in determining the useful life of acquired intangible assets. The amounts and useful lives assigned to identified intangible assets impacts the amount and timing of future amortization expense.

The value of our goodwill and intangible assets could be impacted by future adverse changes such as, but not limited to: a substantial decline in our market capitalization; an adverse action or assessment by a regulator; and unanticipated competition.

We evaluate and test goodwill for impairment at least annually during the fourth quarter or more often if and when circumstances indicate that goodwill may not be recoverable. Each period we evaluate the estimated remaining useful life of our intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization. We evaluate long-lived assets, such as property and equipment, and purchased intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Such events or changes in circumstances include, but are not limited to, a significant decrease in the fair value of the underlying asset, a significant decrease in the benefits realized from the acquired assets, difficulty and delays in integrating the business or a significant change in the operations of the acquired assets or use of an asset. A long-lived asset is considered impaired if its carrying amount exceeds the estimated future undiscounted cash flows the asset is expected to generate. If a long-lived asset is considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the asset exceeds the fair value of the asset or asset group.

Business Combinations. Accounting for business combinations requires us to make significant estimates and assumptions, especially at the acquisition date with respect to tangible and intangible assets acquired and liabilities assumed and pre-acquisition contingencies. We use our best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date.

Examples of critical estimates in valuing certain of the intangible assets and goodwill we have acquired include but are not limited to:

- future net expected cash flows from subscription and support contracts, professional services contracts, other customer contracts and acquired developed technologies and patents;
- the acquired company’s trade name, trademark and existing customer relationships, as well as assumptions about the period of time the acquired trade name and trademark will continue to be used in our offerings;
- uncertain tax positions and tax related valuation allowances assumed; and
- discount rates.

Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results.

Stock-Based Options and Awards. We recognize the fair value of our stock options and awards on a straight-line basis over the requisite service period of the option or award which is the vesting term of generally four years for stock

options and restricted stock awards and one year for shares issued pursuant to our Employee Stock Purchase Plan ("ESPP"). The fair value of each option or ESPP share or stock purchase right is estimated on the date of grant using the Black-Scholes option pricing

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model. The estimated forfeiture rate applied is based on historical forfeiture rates. We evaluate the forfeiture rates at least annually, or when events or circumstances indicate a change may be needed. This may cause a fluctuation in our stock-based expense in the period of change. Inputs into the Black-Scholes option pricing model and other factors that may affect our stock-based expense include:

- The estimated life for the stock options which is estimated based on an actual analysis of expected life. The estimated life for shares issued pursuant to our ESPP is based on the two purchase periods within the 12 month offering period;
- The risk free interest rate which is based on the rate for a U.S. government security with the same estimated life at the time of the option grant and the stock purchase rights;
- The future stock price volatility which is estimated considering both our observed option-implied volatilities and our historical volatility calculations. We believe this is the best estimate of the expected volatility over the expected life of our stock options and stock purchase rights; and
- The probability of achieving performance conditions to which certain awards may be subject.

Income Taxes. We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the condensed consolidated statements of operations in the period that includes the enactment date. At each of the interim financial reporting periods, we compute our tax provision by applying an estimated annual effective tax rate to year to date ordinary income or loss and adjust the provision for discrete tax items recorded in the same period. The estimated annual effective tax rate at each interim period represents our best estimate based on evaluations of possible future transactions and may be subject to subsequent refinement or revision. We consider the valuation allowance in estimating the annual effective tax rate. As a result, the annual effective tax rate could be volatile and is therefore difficult to forecast in future periods.

Valuation allowances are established when necessary to reduce deferred tax assets to the amounts that are more likely than not expected to be realized based on the weighting of positive and negative evidence. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback or carryforward periods available under the applicable tax law. We regularly review the deferred tax assets for recoverability based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. Our judgment regarding future profitability may change due to many factors, including future market conditions and the ability to successfully execute our business plans and tax planning strategies. Should there be a change in the ability to recover deferred tax assets, our income tax provision would increase or decrease in the period in which the assessment is changed.

Our tax positions are subject to income tax audits by multiple tax jurisdictions throughout the world. We recognize the tax benefit of an uncertain tax position only if it is more likely than not that the position is sustainable upon examination by the taxing authority, based on the technical merits. The tax benefit recognized is measured as the largest amount of benefit which is greater than 50 percent likely to be realized upon settlement with the taxing authority. We recognize interest accrued and penalties related to unrecognized tax benefits in our income tax provision.

Strategic Investments. We hold strategic investments in marketable equity securities and non-marketable debt and equity securities in which we do not have a controlling interest or significant influence, as defined in Accounting Standards Codification 323 (“ASC 323”), Investments - Equity Method and Joint Ventures. Marketable equity securities are measured using quoted prices in their respective active markets and non-marketable debt and equity securities are recorded at cost and presented in the condensed consolidated balance sheet. If, based on the terms of our ownership of these marketable and non-marketable securities, we determine that we exercise significant influence on the entity to which these marketable and non-marketable securities relate, we apply the requirements of ASC 323 to account for such investments.

We determine the fair value of our marketable equity securities and non-marketable debt and equity securities quarterly for impairment and disclosure purposes; however, the non-marketable debt and equity securities are recorded at fair value only if an impairment is recognized. The measurement of fair value requires significant judgment and includes a qualitative and quantitative analysis of events and circumstances that impact the fair value of the investment. Our assessment of the severity and duration of the impairment and qualitative and quantitative analysis includes the investee’s financial metrics, the investee’s products and technologies meeting or exceeding predefined milestones, market acceptance of the product or technology, other competitive products or technology in the market, general market conditions, management and governance structure of the investee, investee’s liquidity, debt ratios and the rate at which the investee is using its cash, and investee’s receipt of additional

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funding at a lower valuation. In determining the estimated fair value of our strategic investments in privately held companies, we utilize the most recent data available to us. Valuations of privately held companies are inherently complex due to the lack of readily available market data.

If the fair value of an investment is below our cost, we determine whether the investment is other-than-temporarily impaired based on our qualitative and quantitative analysis, which includes the severity and duration of the impairment. If the investment is considered to be other-than-temporarily impaired, we record the investment at fair value by recognizing an impairment and establishing a new cost basis for the investment.

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Results of Operations

The following tables set forth selected data for each of the periods indicated (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Revenues:				
Subscription and support	$1,596,333	$1,288,513	$4,522,939	$3,668,406
Professional services and other	115,634	95,142	334,879	260,572
Total revenues	1,711,967	1,383,655	4,857,818	3,928,978
Cost of revenues (1)(2):				
Subscription and support	303,045	238,746	870,023	666,611
Professional services and other	120,638	94,465	340,846	266,736
Total cost of revenues	423,683	333,211	1,210,869	933,347
Gross profit	1,288,284	1,050,444	3,646,949	2,995,631
Operating expenses (1)(2):				
Research and development	239,212	195,460	695,440	586,927
Marketing and sales	818,820	709,643	2,349,449	2,020,956
General and administrative	186,818	167,383	544,314	498,565
Operating lease termination resulting from purchase of 50 Fremont, net	0	0	(36,617)	0
Total operating expenses	1,244,850	1,072,486	3,552,586	3,106,448
Income (loss) from operations	43,434	(22,042)	94,363	(110,817)
Investment income	3,507	2,622	11,351	7,055
Interest expense	(18,249)	(17,682)	(53,020)	(56,355)
Other expense (1)(3)	(7,093)	(372)	(6,064)	(15,095)
Gain on sales of land and building improvements	21,792	15,625	21,792	15,625
Income (loss) before provisions for income taxes	43,391	(21,849)	68,422	(159,587)
Provisions for income taxes	(68,548)	(17,075)	(90,339)	(37,336)
Net loss	$(25,157)	$(38,924)	$(21,917)	$(196,923)

(1) Amounts related to amortization of purchased intangibles from business combinations, as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Cost of revenues	$20,296	$20,351	$60,825	$70,294
Marketing and sales	18,966	15,095	57,995	44,708
Other non-operating expense	761	0	2,877	0

(2) Amounts related to stock-based expenses, as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Cost of revenues	$17,516	$14,118	$49,237	$38,905
Research and development	31,534	26,868	96,508	87,264
Marketing and sales	69,561	72,892	211,819	210,510
General and administrative	25,706	25,582	77,092	76,284

(3) Amount includes approximately $10.2 million loss on conversions of our convertible 0.75% senior notes due January 2015 recognized during the nine months ended October 31, 2014.

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Revenues by geography were as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Americas	$1,258,148	$995,331	$3,575,441	$2,812,654
Europe	302,704	252,982	848,413	730,324
Asia Pacific	151,115	135,342	433,964	386,000
	$1,711,967	$1,383,655	$4,857,818	$3,928,978

Americas revenue attributed to the United States was approximately 95 percent and 94 percent for the three and nine months ended October 31, 2015 and 2014, respectively.

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

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Revenues:				