PROOFPOINT INC
Form 10-Q
August 07, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2013
OR

o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from to
Commission File Number 001-35506
PROOFPOINT, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	51-0414846 (I.R.S. employer identification no.)
892 Ross Drive Sunnyvale, California (Address of principal executive offices)	94089 (Zip Code)

(408) 517-4710

(Registrant's telephone number, including area code)

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

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 þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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 o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ Shares of Proofpoint, Inc. common stock, $0.0001 par value per share, outstanding as of July 31, 2013:

35,312,601 shares.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

Proofpoint, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except per share amounts)
(Unaudited)

	June 30, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	$64,818	$39,254
Short-term investments	24,866	47,263
Accounts receivable, net of allowance for doubtful accounts of $208 and $187 at June 30, 2013 and December 31, 2012, respectively	21,054	18,115
Inventory	542	567
Deferred product costs, current	1,092	1,184
Prepaid expenses and other current assets	3,760	3,491
Total current assets	116,132	109,874
Property and equipment, net	9,124	8,560
Deferred product costs, noncurrent	287	326
Goodwill	20,009	18,557
Intangible assets, net	5,745	2,913
Other noncurrent assets	3,546	211
Total assets	$154,843	$140,441
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$5,391	$2,496
Accrued liabilities	10,512	12,078
Notes payable and lease obligations, current	1,678	1,658
Deferred rent	554	462
Deferred revenue, current	68,694	62,642
Total current liabilities	86,829	79,336
Notes payable and lease obligations, noncurrent	1,525	2,354
Other long term liabilities, noncurrent	1,311	726
Deferred revenue, noncurrent	25,780	24,217
Total liabilities	115,445	106,633
Stockholders' Equity		
Common stock, $0.0001 par value; 200,000 shares authorized at June 30, 2013 and December 31, 2012, respectively; 35,119 and 33,044 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	4	3
Additional paid-in capital	230,340	216,280
Accumulated other comprehensive (loss) income	(10)	3
Accumulated deficit	(190,936)	(182,478)
Total stockholders' equity	39,398	33,808

Total liabilities and stockholders’ equity	$154,843	$140,441

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Revenue:				
Subscription	$30,816	$24,750	$59,268	$48,019
Hardware and services	1,011	1,193	3,323	2,543
Total revenue	31,827	25,943	62,591	50,562
Cost of revenue:(1)(2)				
Subscription	8,276	7,236	16,105	14,447
Hardware and services	1,203	1,134	2,442	2,303
Total cost of revenue	9,479	8,370	18,547	16,750
Gross profit	22,348	17,573	44,044	33,812
Operating expense:(1)(2)				
Research and development	7,591	6,224	15,153	12,105
Sales and marketing	16,239	13,450	32,367	25,625
General and administrative	3,777	2,964	7,679	5,730
Total operating expense	27,607	22,638	55,199	43,460
Operating loss	(5,259)	(5,065)	(11,155)	(9,648)
Interest (expense) income, net	(5)	(43)	7	(103)
Other expense, net	(148)	(178)	(515)	(209)
Loss before benefit from (provision for) income taxes	(5,412)	(5,286)	(11,663)	(9,960)
Benefit from (provision for) income taxes	3,347	(232)	3,205	(311)
Net loss	$(2,065)	$(5,518)	$(8,458)	$(10,271)
Net loss per share, basic and diluted	$(0.06)	$(0.21)	$(0.25)	$(0.65)
Weighted average shares outstanding, basic and diluted	34,625	26,195	34,028	15,907
(1) Includes stock based compensation expense as follows:				
Cost of subscription revenue	$196	$109	$428	$238
Cost of hardware and services revenue	39	15	75	26
Research and development	559	485	1,064	907
Sales and marketing	847	820	1,621	1,471
General and administrative	511	506	1,035	794
(2) Includes intangible amortization expense as follows:				
Cost of subscription revenue	$413	$1,019	$739	$2,119
Research and development	8	7	16	15
Sales and marketing	228	146	298	317
General and administrative	11	—	11	—

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net loss	$(2,065)	$(5,518)	$(8,458)	$(10,271)
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on investments, net	1	(11)	(13)	(9)
Comprehensive loss	$(2,064)	$(5,529)	$(8,471)	$(10,280)

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities		
Net loss	$(8,458)	$(10,271)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,701	4,499
Accretion of investments	386	—
Provision for allowance for doubtful accounts	17	—
Stock based compensation	4,223	3,436
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	(2,841)	3,552
Inventory	25	223
Deferred products costs	131	768
Prepaid expenses and other current assets	(129)	(311)
Noncurrent assets	(3,334)	59
Accounts payable	1,303	(1,296)
Accrued liabilities	(2,273)	790
Deferred rent	92	(5)
Deferred revenue	7,615	(334)
Net cash provided by operating activities	458	1,110
Cash flows from investing activities		
Proceeds from sales and maturities of short-term investments	42,386	2,939
Purchase of short-term investments	(20,387)	(35,198)
Purchase of property and equipment	(1,990)	(2,443)
Acquisition of business, net of cash acquired	(3,771)	—
Net cash provided by (used in) investing activities	16,238	(34,702)
Cash flows from financing activities		
Proceeds from issuance of common stock, net of repurchases	9,705	1,761
Proceeds from initial public offering, net of offering costs	—	68,405
Repayments of equipment financing loans	(837)	(184)
Net cash provided by financing activities	8,868	69,982
Net increase in cash and cash equivalents	25,564	36,390
Cash and cash equivalents		
Beginning of period	39,254	9,767
End of period	$64,818	$46,157
Supplemental disclosure of noncash investing and financing information		
Unpaid initial public offering costs	$—	$108
Unpaid purchase of property and equipment	$1,857	$275

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)
(Dollars and share amounts in thousands, except per share amounts)

1. The Company and Summary of Significant Accounting Policies

The Company

Proofpoint, Inc. (the “Company”) was incorporated in Delaware in June 2002 and is headquartered in California. Proofpoint is a pioneering security-as-a-service vendor that enables large and mid-sized organizations worldwide to defend, protect, archive and govern their most sensitive data. The Company’s security-as-a-service platform is comprised of a number of data protection solutions, including threat protection, regulatory compliance, archiving and governance, and secure communication.

Basis of Presentation and Consolidation

The accompanying unaudited Condensed Consolidated Financial Statements and condensed footnotes have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary (consisting only of normal recurring adjustments) for fair statement of results for the interim periods presented have been included. The results of operations for the three and six months ended June 30, 2013 and 2012 are not necessarily indicative of the results to be expected for the year ended December 31, 2013 or for other interim periods or for future years.

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated on consolidation. The accompanying Condensed Consolidated Balance Sheet as of December 31, 2012 is derived from audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These accompanying Condensed Consolidated Financial Statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's 2012 Annual Report on Form 10-K.

There have been no material changes to the Company's significant accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 except as otherwise described below.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates and such difference may be material to the financial statements.

Business Combinations

The accompanying Condensed Consolidated Financial Statements include the operations of an acquired business after the completion of the acquisition. The Company accounts for acquired businesses using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed be recognized at their estimated fair values as of the acquisition date, while transaction costs are expensed as incurred. The measurement of fair value of assets and liabilities

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assumed requires significant judgment. Any excess of the purchase price over the fair value of the net assets acquired is recorded as goodwill.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price of the acquired enterprise over the fair value of identifiable assets acquired and liabilities assumed. The Company applies Accounting Standards Codification ("ASC") 350, “Intangibles—Goodwill and Other”, and performs an annual goodwill impairment test during the fourth quarter of the Company’s fiscal year and more frequently if an event or circumstance indicates that an impairment may have occurred. For the purposes of impairment testing, the Company has determined that it has one reporting unit. A two-step impairment test of goodwill is required pursuant to ASC 350-20-35. In the first step, the Company conducts an assessment of qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If the Company determines that it is more likely than not that the fair value of its reporting unit is less than its carrying amount, it then conducts the second step, a two-part test for impairment of goodwill. The Company first compares the fair value of its reporting unit to its carrying value. If the fair value exceeds the carrying value of the net assets, goodwill is not considered impaired and no further analysis is required. If the carrying value of the net assets exceeds the fair values of the reporting unit, then the second part of the impairment test must be performed in order to determine the implied fair value of the goodwill. The implied fair value of goodwill is calculated by deducting the fair value of all tangible and intangible net assets of the reporting unit, excluding goodwill, from the fair value of the reporting unit as determined in the first step. If the carrying value of the goodwill exceeds the implied fair value, then an impairment loss equal to the difference would be recorded. The identification and measurement of goodwill impairment involves the estimation of the fair value of the Company. The estimate of fair value of the Company, based on the best information available as of the date of the assessment, is subjective and requires judgment, including management assumptions about expected future revenue forecasts and discount rates. No impairment to the carrying value of goodwill was identified to date by the Company during the six months ended June 30, 2013.

Intangible assets consist of developed technology, customer relationships, vendor relationships, non-compete arrangements and trademarks and patents. The values assigned to intangibles are based on estimates and judgments regarding expectations for success and life cycle of solutions and technologies acquired.

Intangible assets are amortized on a straight-line basis over their estimated lives, which approximate the pattern in which the economic benefits of the intangible assets are consumed, typically ranging from one to seven years.

Revenue Recognition

The Company derives its revenue primarily from two sources: (1) subscription revenue for rights related to the use of the security-as-a-service platform and (2) hardware, training and professional services revenue provided to customers related to their use of the platform. Subscription revenue is derived from a subscription based enterprise licensing model with contract terms typically ranging from one to three years, and consist of (i) subscription fees from the licensing of the security-as-a-service platform, (ii) subscription fees for access to the on-demand elements of the platform and (iii) subscription fees for the right to access the Company’s customer support services.

The Company applies the provision of ASC 985-605, “Software Revenue Recognition", and related interpretations, to all transactions involving the licensing of software, as well as related support, training, and other professional services. ASC 985-605 requires revenue earned on software arrangements involving multiple elements such as software license, support, training and other professional services to be allocated to each element based on the relative fair values of these elements. The fair value of an element must be based on vendor specific objective evidence (“VSOE”) of fair value. VSOE of fair value of each element is based on the price charged when the element is sold separately. Revenue is recognized when all of the following criteria are met as set forth in ASC 985-605:

- Persuasive evidence of an arrangement exists,
- Delivery has occurred,
- The fee is fixed or determinable, and

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- Collectability is probable.

The Company has analyzed all of the elements included in its multiple element arrangements and has determined that it does not have sufficient VSOE of fair value to allocate revenue to its subscription and software license agreements, support, training, and professional services. The Company defers all revenue under the software arrangement until the commencement of the subscription services and any associated professional services. Once the subscription services and the associated professional services have commenced, the entire fee from the arrangement is recognized ratably over the remaining period of the arrangement. If the professional services are essential to the functionality of the subscription, then the revenue recognition does not commence until such services are completed.

In the accompanying Condensed Consolidated Statement of Operations, revenue is categorized as "subscription" and "hardware and services." Although the Company is unable to separate its multiple elements under the applicable revenue recognition guidance since it does not have sufficient VSOE of fair value for revenue recognition purposes, the Company has used a systematic and rational estimate to classify revenue between "subscription" and "hardware and services." For presentation purposes only, the Company allocates revenue to hardware and services based upon management's best estimate of fair value of such deliverables using a cost plus model. The remaining consideration of the arrangement is then allocated to subscription services. Management believes that this methodology provides a reasonable basis to allocate revenue between subscription and hardware and services for presentation purposes.

The hosted on-demand service agreements do not provide customers with the right to take possession of the software supporting the hosted service. The Company recognizes revenue from its hosted on-demand services in accordance with ASC 605-20, and as such recognizes revenue when the following criteria are met:

- Persuasive evidence of an arrangement exists,
- Delivery of the Company’s obligations to its customers has occurred,
- Collection of the fees is probable, and
- The amount of fees to be paid by the customer is fixed or determinable.

In October 2009, the FASB amended the accounting guidance for multiple element arrangements (“ASU 2009-13”) to:

- Provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the arrangement consideration should be allocated among its elements;
- Require an entity to allocate revenue in an arrangement that has separate units of accounting using best estimated selling price (“BESP”) of deliverables if a vendor does not have VSOE of fair value or third-party evidence of selling price (“TPE”), and
- Eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method to the separate unit of accounting.

Concurrently, the FASB amended the accounting guidance for revenue recognition (“ASU 2009-14”) to exclude hardware appliances containing software components and hardware components that function together to deliver the hardware appliance’s essential functionality from the scope of the software revenue recognition guidance of ASC 985-605.

The Company elected to adopt this new guidance in the first quarter of fiscal 2011 for new and materially modified revenue arrangements originating after January 1, 2011.

Prior to the adoption of ASU 2009-14, revenue derived from hardware appliance sales were recognized based on the software revenue recognition guidance. The Company could not establish VSOE of fair value for the undelivered elements in the arrangement, and therefore the entire fee from the arrangement was recognized ratably over the contractual term of the

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agreement. In addition, the Company was unable to establish VSOE of fair value of its hosted on-demand service agreements, and therefore the entire fee for the agreement was recognized ratably over the contractual term of the agreement.

As a result of the adoption of this accounting guidance, revenue derived from subscription services and hardware appliance sales are no longer subject to industry specific software revenue recognition guidance. For all arrangements within the scope of these new accounting pronouncements, including the Company's hosted on-demand services, the Company evaluates each element in a multiple element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company's control. Revenue derived from the licensing of the security-as-a-service platform continues to be accounted for in accordance with the industry specific revenue recognition guidance.

Hardware appliance revenue is recognized upon shipment. Subscription and support revenue are recognized over the contract period commencing on the start date of the contract. Professional services and training, when sold with hardware appliances or subscription and support services, are accounted for separately when those services have standalone value. In determining whether professional services and training services can be accounted for separately from subscription and support services, the Company considers the following factors: availability of the services from other vendors, the nature of the services, and the dependence of the subscription services on the customer's decision to buy the professional services. If professional services and training do not qualify for separate accounting, the Company recognizes the professional services and training ratably over the contract term of the subscription services.

Delivery generally occurs when the hardware appliance is delivered to a common carrier freight on board shipping point by the Company or the hosted service has been activated and communicated to the customer accordingly. The Company's fees are typically considered to be fixed or determinable at the inception of an arrangement and are negotiated at the outset of an arrangement, generally based on specific products and quantities to be delivered. In the event payment terms are provided that differ significantly from the Company's standard business practices, the fees are deemed to not be fixed or determinable and revenue is recognized as the fees become paid.

The Company assesses collectability based on a number of factors, including credit worthiness of the customer and past transaction history of the customer. Through June 30, 2013, the Company experienced no significant credit losses.

Deferred Revenue

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from the sale of the Company's subscription fees, training and professional services. Once the revenue recognition criteria are met, this revenue is recognized ratably over the term of the associated contract, which typically ranges from 12 to 36 months.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to their short maturities. Based on borrowing rates that are available to the Company for loans with similar terms and consideration of the Company's credit risk, the carrying value of the note payable approximates its fair value and is a Level 2 measurement within the fair value hierarchy.

Comprehensive Loss

Comprehensive loss includes all changes in equity that are not the result of transactions with stockholders. The Company's comprehensive loss consists of its net loss and changes in unrealized gains (losses) from its available-for-sale investments. Total comprehensive loss has been presented in the accompanying Condensed Consolidated Statements of Comprehensive Loss.

During the six months ended June 30, 2013, the Company adopted Accounting Standards Update ("ASU") 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income", which requires filers to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net loss. The Company had no significant reclassifications out of accumulated other comprehensive loss into net loss for the three and six months ended June 30, 2013 and 2012.

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Recent Accounting Pronouncements

In July 2013, the FASB issued ASU 2013-11, "Income Taxes", a new accounting standard update on the financial statement presentation of unrecognized tax benefits. The new guidance provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. The new guidance becomes effective for the Company on January 1, 2014 and it should be applied prospectively to unrecognized tax benefits that exist at the effective date with retrospective application permitted. The Company is currently assessing the impacts of this new guidance.

2. Acquisition

On April 5, 2013 (the "Acquisition Date"), pursuant to the terms of a share transfer agreement, the Company purchased all of the outstanding share capital of Mail Distiller Limited, a Northern Ireland Company ("Mail Distiller" and the "Acquisition") for $4,500. Mail Distiller is a European-based provider of the Security as a Service ("SaaS") email security solutions. The Acquisition allows the Company to create the Proofpoint Essentials™ product line, a suite of SaaS security and compliance solutions specifically designed for distribution across managed service providers and dedicated security resellers.

The Acquisition was accounted for under the acquisition method of accounting in which the tangible and identifiable intangible assets and liabilities of Mail Distiller were recorded at their respective fair values as of the Acquisition Date, including an amount for goodwill representing the difference between the Acquisition consideration and the fair value of identifiable net assets. The Company expects the combined entity to achieve savings in corporate overhead costs and opportunities for growth through expanded geographic and customer segment diversity with the ability to leverage additional products and capabilities. These factors, among others, contributed to a purchase price in excess of the estimated fair value of Mail Distiller's net identifiable assets acquired and, as a result, goodwill was recorded in connection with the Acquisition. The goodwill is not deductible for tax purposes.

At June 30, 2013, with the help of third-party specialists, the Company completed the valuation of the estimated fair values for the assets acquired and liabilities assumed at the Acquisition Date and the results of operations of Mail Distiller and the fair values of the assets acquired and liabilities assumed have been included in the accompanying Condensed Consolidated Financial Statements since the Acquisition Date. For the three months ended June 30, 2013, the Company recorded $102 in revenue and recognized a pre-tax net loss of $392 from Mail Distiller.

As of June 30, 2013, the Company paid $3,771 in cash considerations, net of cash acquired, with $669 held back to secure indemnification obligations, which has not been released as of the filing of this Quarterly Report on Form 10-Q. The Company incurred $127 in acquisition-related costs which were recorded in operating expenses for the six months ended June 30, 2013.

Fair value of assets acquired and liabilities assumed

The following table summarizes the provisional fair values of tangible assets acquired, liabilities assumed, intangible assets and goodwill:

	Estimated Fair Value in USD	Estimated Useful Life (in years)
Tangible assets acquired	$204	N/A
Liabilities assumed	(1,052)	N/A
Trade name	7	1
Customer relationships	1,291	2
Non-compete agreements	123	2

Core/developed technology	2,475	7
Goodwill	1,452	Indefinite
	$4,500	

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Pro forma financial information

The following pro forma financial information presents the combined results of operations for the three and six months ended June 30, 2013 and 2012 as if the Acquisition had been completed on January 1, 2012, with adjustments to give effect to pro forma events that are directly attributable to the Acquisition. The pro forma results do not reflect any operating efficiencies or potential cost savings that may result from the consolidation of the operations of the Company and Mail Distiller. Accordingly, these pro forma results are presented for informational purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the Acquisition had occurred at the beginning of the period presented, nor are they indicative of future results of operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Total revenue	$31,834	$26,121	$62,809	$50,905
Net loss	(2,006)	(5,820)	(8,758)	(10,933)
Basic and diluted loss per share	$(0.06)	$(0.22)	$(0.26)	$(0.69)

The pro forma financial information excludes non-recurring Acquisition-related transaction costs incurred by the Company of $88 and $127, respectively, for the three and six months ended June 30, 2013. None was incurred in 2012.

3. Goodwill and Intangible Assets

The goodwill activity and balances are presented below:

	June 30, 2013
Balance at December 31, 2012	$18,557
Add: Goodwill from acquisitions	1,452
Balance at June 30, 2013	$20,009

The goodwill balance as of June 30, 2013 was the result of the acquisitions of Fortiva, Inc., Secure Data in Motion, Inc. (“Sigaba”), Everyone.net, Inc. (“EDN”), GFI Software Ltd., Spam and Open Relay Blocking System (“SORBS”), NextPage, Inc. and the Mail Distiller acquisition in the second quarter of 2013.

Intangible Assets

Intangible assets excluding goodwill, consisted of the following:

	June 30, 2013			December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$20,116	$(15,902)	$4,214	$17,641	$(15,163)	$2,478
Customer relationships	3,699	(2,392)	1,307	2,408	(2,109)	299
Non-compete agreements	229	(55)	174	106	(27)	79
Trademark and patents	105	(55)	50	98	(41)	57
	$24,149	$(18,404)	$5,745	$20,253	$(17,340)	$2,913

Amortization expense of intangibles totaled $660 and $1,172, respectively, for the three months ended June 30, 2013 and 2012 and $1,064 and $2,451, respectively, for the six months ended June 30, 2013 and 2012.

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Future estimated amortization expense of intangible assets as of June 30, 2013 is presented below:

2013, remainder	$1,202
2014	1,782
2015	1,250
2016	353
2017	352
Thereafter	806
	$5,745

4. Fair Value Measurements and Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. A hierarchy for inputs used in measuring fair value has been defined to minimize the use of unobservable inputs by requiring the use of observable market data when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on active market data. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances.

The fair value hierarchy prioritizes the inputs into three broad levels:

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

The Company's Level 1 assets generally consist of money market funds.

- Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

The Company's Level 2 assets and liabilities generally consist of corporate bonds and agency debt securities, commercial paper, and certificates of deposit.

- Level 3: Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

As of June 30, 2013 and December 31, 2012, the Company had no financial assets or liabilities that required Level 3 classification, including those that have unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets and liabilities.

The following tables summarize, for each category of assets or liabilities, the respective fair value as of June 30, 2013 and December 31, 2012 and the classification by level of input within the fair value hierarchy.

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	Balance as of June 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market funds	$49,943	$49,943	$—
Short-term investments:			
Corporate debt securities	16,870	—	16,870
Commercial paper	5,996	—	5,996
Certificates of deposit	2,000	—	2,000
Total financial assets	$74,809	$49,943	$24,866

	Balance as of December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market funds	$26,485	$26,485	$—
Commercial paper	1,020	1,020	—
Short-term investments:			
Corporate debt securities	29,267	—	29,267
Commercial paper	15,988	—	15,988
Certificates of deposit	2,008	—	2,008
Total financial assets	$74,768	$27,505	$47,263

Financial Instruments

The cost and fair value of the Company's available-for-sale investments as of June 30, 2013 and December 31, 2012 were as follows:

	June 30, 2013			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and Cash Equivalents:				
Cash	$14,875	$—	$—	$14,875
Money market funds	49,943	—	—	49,943
Total	$64,818	$—	$—	$64,818
Short term investments:				
Corporate debt securities	$16,880	$3	$(13)	$16,870
Commercial paper	5,996	—	—	5,996
Certificates of deposit	2,000	—	—	2,000
Total	$24,876	$3	$(13)	$24,866

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	December 31, 2012			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and Cash Equivalents:				
Cash	$11,749	$—	$—	$11,749
Money market funds	26,485	—	—	26,485
Commercial paper	1,020	—	—	1,020
Total	$39,254	$—	$—	$39,254
Short term investments:				
Corporate debt securities	$29,266	$4	$(3)	$29,267
Commercial paper	15,987	1	—	15,988
Certificates of deposit	2,007	1	—	2,008
Total	$47,260	$6	$(3)	$47,263

As of June 30, 2013 and December 31, 2012, all investments mature in less than one year. Estimated fair values for marketable securities are based on quoted market prices for the same or similar instruments.

5. Commitments and Contingencies

Operating Leases

The Company has noncancellable operating leases with various expiration dates through May 2017.

Rent expense was $403 and $381, respectively, for the three months ended June 30, 2013 and 2012 and $803 and $771, respectively, for the six months ended June 30, 2013 and 2012.

Capital Leases

In July 2012, the Company entered into two lease agreements to lease certain office equipment with expiration dates in July and October 2015. These leases bear an annual interest rate of 4.5% and are secured by fixed assets used in the Company's office locations.

At June 30, 2013, future annual minimum lease payments under noncancellable operating and capital leases were as follows:

	Capital Leases	Operating Leases
2013, remainder	$9	$2,927
2014	18	3,337
2015	11	741
2016	—	306
2017	—	130
Total minimum lease payments	38	$7,441
Less: Amount representing interest	(2)	
Present value of capital lease obligations	36	
Less: Current portion	(17)	
Long-term portion of capital lease obligations	$19	

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Contingencies

Under the indemnification provisions of the Company's customer agreements, the Company agrees to indemnify and defend and hold harmless its customers against, among other things, infringement of any patent, trademark or copyright under any country's laws or the misappropriation of any trade secret arising from the customers' legal use of the Company's solutions. The exposure to the Company under these indemnification provisions is generally limited to the total amount paid by the customers under the applicable customer agreement. However, certain indemnification provisions potentially expose the Company to losses in excess of the aggregate amount paid to the Company by the customer under the applicable customer agreement. To date, there have been no material claims against the Company pursuant to these indemnification provisions.

Legal Contingencies

From time to time, the Company is involved in claims and legal proceedings that arise in the ordinary course of business. Based on currently available information, management does not believe that the ultimate outcome of these unresolved matters, individually and in the aggregate, is likely to have a material adverse effect on the Company's financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and the Company's view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the Company's financial position, results of operations or cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods.

6. Debt

Equipment Financing Loans

The Company entered into a new equipment loan agreement with Silicon Valley Bank in April 2011 for an aggregate loan principal amount of $6,000. Interest on the advances is equal to prime rate plus 0.5%. As of June 30, 2013, the interest rate on the outstanding advances was 4.5%. The Company had the ability to draw down on this equipment line through April 19, 2012. Each drawn amount is due 48 months after funding. Borrowings outstanding under the equipment loan at June 30, 2013 were $3,147. Equipment financed under this loan arrangement is collateralized by the respective assets underlying the loan. The terms of the loan restrict the Company's ability to pay dividends. The loan includes a covenant that requires the Company to maintain cash and cash equivalents plus net accounts receivable of at least two times the amount of all outstanding indebtedness. As of June 30, 2013, the Company was in compliance with the financial covenant.

Interest expense was $38 and $57, respectively, for the three months ended June 30, 2013 and 2012, and $80 and $109, respectively, for the six months ended June 30, 2013 and 2012.

At June 30, 2013, the remaining repayment commitments related to the equipment loans are as follows:

2013, remainder	$821
2014	1,642
2015	684
	$3,147

Third-Party Financing

As part of the Acquisition, the Company assumed a bank loan held by Mail Distiller. As of June 30, 2013, the outstanding balance was $20.

7. Stockholders' Equity

Initial Public Offering

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In April 2012, the Company completed its initial public offering of its common stock to the public (“IPO”) whereby 5,859 shares of common stock sold by the Company (inclusive of 729 shares of common stock from the partial exercise of the overallotment option granted to the underwriters) and 1,370 shares of common stock sold by the selling shareholders (inclusive of 171 shares of common stock from the partial exercise of the overallotment option granted to the underwriters). The public offering price of the shares sold in the offering was $13.00 per share. The Company did not receive any proceeds from the sales of shares by the selling stockholders. The total gross proceeds from the offering to the Company were $76,200. After deducting underwriters’ discounts and commissions and offering expenses, the aggregate net proceeds received by the Company totaled approximately $68,300. Immediately prior to the closing of the IPO, all shares of the Company’s outstanding redeemable convertible preferred stock automatically converted into 19,567 shares of common stock. As a result, following the IPO, the Company has two classes of authorized stock: Common stock and Preferred stock.

As of June 30, 2013, the Company is authorized to issue two classes of stock totaling 205,000 shares, of which 5,000 are designated as preferred stock and 200,000 are designated common stock, each with a par value of $0.0001 per share. The Company had 35,119 and 33,044 shares, respectively, issued and outstanding at June 30, 2013 and December 31, 2012.

On March 30, 2012, the Company's Board of Directors approved a 1-for-2 reverse stock split of the Company's common stock. The reverse stock split became effective on April 2, 2012. All of the share numbers, share prices, and exercise prices have been retrospectively adjusted to reflect the reverse stock split.

Number of shares of common stock reserved for future issuance was as follows:

	As of June 30, 2013	As of December 31, 2012
Options available for future grant under the stock plans	5,653	4,611
Options outstanding under stock option plans	8,248	9,636
Shares available for future issuance under ESPP	860	646
Common stock issuable upon settlement of outstanding restricted stock units	39	1
Total shares reserved	14,800	14,894

Stock Option Plan

On March 30, 2012, the Board of Directors and the Company’s stockholders approved the 2012 Equity Incentive Plan (the "2012 Plan"), which became effective in April 2012. The Company has two equity incentive plans: the Company’s 2002 stock option plan (the “2002 Plan”) and the 2012 Plan. Upon the IPO, all shares that were reserved under the 2002 Plan but not issued, and shares issued but subsequently returned to the plan through forfeitures, cancellations and repurchases became part of the 2012 Plan and no further shares will be granted pursuant to the 2002 Plan. All outstanding stock awards under the 2002 and 2012 Plans (collectively, the "Plan") will continue to be governed by their existing terms. Under the 2012 Plan, the Company has the ability to issue incentive stock options (“ISOs”), nonstatutory stock options (“NSOs”), restricted stock awards, stock bonus awards, stock appreciation rights ("SARs"), restricted stock units (“RSUs”), and performance shares. The 2012 Plan also allows direct issuance of common stock to employees, outside directors and consultants at prices equal to the fair market value at the date of grant of options or issuance of common stock. Additionally, the 2012 Plan provides for the grant of performance cash awards to employees, directors and consultants. The Company has the right to repurchase any unvested shares (at the option exercise price) of common stock issued directly or under option exercises. The right of repurchase generally expires over the vesting period.

Under the 2002 and 2012 Plans, the term of an option grant shall not exceed ten years from the date of its grant and options generally vest over a three to four-year period, with vesting on a monthly or annual interval. 20,316 shares of common stock were initially reserved for issuance to eligible participants, under the 2012 Plan. As of June 30, 2013, 5,653 shares were available for future grant. Restricted stock awards generally vest over a four-year period with 25% vesting at the end of one year and the remaining vest monthly thereafter. The number of shares available for grant and issuance under the 2012 Plan will be increased automatically on each January 1 of 2013 through 2016 by an amount equal to 5% of the Company's shares outstanding on the immediately preceding December 31, but not to exceed 3,724 shares, unless the Board of Directors, in its

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discretion, determines to make a smaller increase. On January 1, 2013, the number of shares of the Company's common stock available for grant and issuance under the 2012 Plan increased by 1,652 shares.

Stock option activity under the Plan was as follows:

	Shares subject to Options Outstanding			
	Number of Shares	Weighted Average Exercise Price per share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balance at December 31, 2012	9,636	$5.63	7.33	$64,719
Options granted	1,360	15.21		
Options exercised	(1,959)	4.36		
Options forfeited and canceled	(789)	7.85		
Balance at June 30, 2013	8,248	$7.30	7.30	$139,815

The total intrinsic value of options exercised was $24,063 and $9,783, respectively, for the six months ended June 30, 2013 and 2012. Total cash proceeds from such option exercises were $8,543 and $1,780, respectively, for the six months ended June 30, 2013 and 2012.

Restricted Stock Units

The fair value of each unit is based on the fair value of the Company’s common stock on the date of assumption. A summary of the status of RSUs awarded and unvested under the stock option plans as of June 30, 2013 is presented below:

	RSUs Outstanding Number of Shares	Granted Fair Value Per Unit
Awarded and unvested at December 31, 2012	1	$7.98
Awards granted	47	19.13
Awards released	(1)	7.98
Awards forfeited	(8)	18.31
Awarded and unvested at June 30, 2013	39	$19.24

Employee Stock Purchase Plan

On March 30, 2012, the Board of Directors and the Company’s stockholders approved the 2012 Employee Stock Purchase Plan (the "ESPP"), which became effective in April 2012. A total of 745 shares of the Company's common stock were initially reserved for future issuance under the ESPP. The number of shares reserved for issuance under the ESPP will increase automatically on January 1 of each of the first eight years commencing with 2013 by the number of shares equal to 1% of the Company's shares outstanding on the immediately preceding December 31, but not to exceed 1,490 shares, unless the Board of Directors, in its discretion, determines to make a smaller increase. As of June 30, 2013, there were 860 shares of the Company's common stock available for future issuance under the ESPP. On January 1, 2013, the number of shares of the Company's common stock reserved and available for issuance under the ESPP increased by 330 shares.

8. Stock Based Compensation

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The Company recognized stock-based compensation expense under the Plan in the accompanying Condensed Consolidated Statements of Operations as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cost of subscription revenue	$196	$109	$428	$238
Cost of hardware and services revenue	39	15	75	26
Research and development	559	485	1,064	907
Sales and marketing	847	820	1,621	1,471
General and administrative	511	506	1,035	794
Total stock-based compensation expense	$2,152	$1,935	$4,223	$3,436

The fair value of options granted is estimated on the grant date using the Black Scholes option valuation model. This valuation model for stock based compensation expense requires the Company to make assumptions and judgments about the variables used in the calculation, including the expected term (weighted average period of time that the options granted are expected to be outstanding), the volatility of the common stock price, an assumed risk-free interest rate and the estimated forfeitures of unvested stock options. To the extent actual forfeitures differ from the estimates, the difference will be recorded as a cumulative adjustment in the period estimates are revised. No compensation cost is recorded for options that do not vest and the compensation cost from vested options, whether forfeited or not, is not reversed.

Prior to the Company's IPO, the Board of Directors, in good faith, determined the fair market values of the Company's common stock, based on the best information available to the Board and the Company's management at the time of grant. The Company performed its analysis in accordance with applicable elements of the practice aid issued by the American Institute of Certified Public Accountants entitled Valuation of Privately Held Company Equity Securities Issued as Compensation. The procedures performed to determine the fair value of the Company's common stock were based on a probability weighted expected return method to estimate the aggregate equity value of the Company.

The weighted average fair value of stock options granted to employees was $10.58 and $11.11, respectively, during the three months ended June 30, 2013 and 2012 and $8.19 and $9.13, respectively, for the six months ended June 30, 2013 and 2012. The fair values were estimated on the grant dates using the Black Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Expected life (in years)	5.90	6.08	6.04	6.08
Volatility	58%	59%	58%	59-60%
Risk-free interest rate	1.1%	1.0%	1.1%	1.0-1.2%
Dividend yield	—%	—%	—%	—%

The estimate for expected life of options granted reflects the midpoint of the vesting term and the contractual life computed utilizing the simplified method as allowed by the SEC staff. The Company does not have significant historical share option exercise experience and hence considers the expected term assumption calculated using the simplified method to be reasonable. The stock volatility assumptions represent an estimate of the historical volatilities of the common stock of a group of publicly traded peer companies that operate in a similar industry. The estimate was determined based on the average historical volatilities of these peer companies. The risk-free interest rate used was the Federal Reserve Bank's constant maturities interest rate commensurate with the expected life of the options in effect at the time of the grant. The expected

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dividend yield was zero, as the Company does not anticipate paying a dividend within the relevant time frame. Expected forfeitures are estimated based on the Company's historical experience.

The Company realized no income tax benefit from stock option exercises in each of the periods presented due to recurring losses and deferred tax asset valuation allowances.

As of June 30, 2013, the Company had unamortized stock based compensation expense of $17,659 related to stock options, that will be recognized net of forfeitures over the average remaining vesting term of the options of 2.64 years. The Company had $565 of unamortized stock based compensation expense related to unvested RSUs, which are expected to be recognized over a weighted average period of 3.81 years.

The fair value of the option component of the ESPP shares was estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Expected life (in years)	0.50	0.53	0.50	*
Volatility	40%	51%	40%	*
Risk-free interest rate	0.1%	0.1%	0.1%	*
Dividend yield	—%	—%	—%	*

* Employee participation in the ESPP did not begin until the second quarter of 2012.

As of June 30, 2013, the Company had $326 of unamortized compensation costs related to the current ESPP offering period, which are expected to be recognized over a weighted average period of 0.33 years.

9. Net Loss per Share

Basic net loss per share of common stock is calculated by dividing the net loss by the weighted average number of shares of common stock outstanding for the period. The weighted average number of shares of common stock used to calculate basic net loss per share of common stock excludes those shares subject to repurchase related to stock options that were exercised prior to vesting as these shares are not deemed to be issued for accounting purposes until they vest. Diluted net loss per share of common stock is computed by dividing the net loss using the weighted average number of shares of common stock, excluding common stock subject to repurchase, and, if dilutive, potential shares of common stock outstanding during the period. Basic and diluted net loss per common share was the same for all periods presented as the impact of all potentially dilutive securities outstanding was anti-dilutive.

The following table presents the potentially dilutive common shares outstanding that were excluded from the computation of diluted net loss per share of common stock for the periods presented because including them would have been anti-dilutive:

	Six Months Ended June 30,	
	2013	2012
Stock options to purchase common stock	8,248	10,194
Common stock subject to repurchase	2	7
Restricted stock units	39	—
Total	8,289	10,201

10. Segment Reporting

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Operating segments are reported in a manner consistent with the internal reporting supported and defined by the components of an enterprise about which separate financial information is available, provided and is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company’s chief operating decision maker is its chief executive officer. The Company’s chief executive officer reviews financial information presented on a consolidated basis and as a result, the Company concluded that there is only one operating and reportable segment.

The following sets forth total revenue and long-lived assets by geographic area. Revenue by geography is based upon the billing address of the customer:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Total revenue:				
United States	$26,288	$21,241	$51,797	$41,306
Rest of World	5,539	4,702	10,794	9,256
Total revenue	$31,827	$25,943	$62,591	$50,562

	As of June 30, 2013	As of December 31, 2012
Long-lived assets:		
United States	$7,379	$6,857
Rest of World	1,745	