

Cornerstone OnDemand Inc  
Form 10-Q  
August 07, 2013

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

Form 10-Q  
(Mark One)

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

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 001-35098

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

Delaware  
(State or other jurisdiction of incorporation or organization)  
1601 Cloverfield Blvd.

13-4068197  
(IRS Employer Identification No.)

Suite 620 South  
Santa Monica, CA 90404  
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code:  
(310) 752-0200

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

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

Large accelerated filer  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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date

Class	Outstanding as of August 2, 2013
Common Stock	51,410,400

CORNERSTONE ONDEMAND, INC.  
 QUARTERLY REPORT ON FORM 10-Q  
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## PART I. FINANCIAL INFORMATION

## ITEM 1. Condensed Consolidated Financial Statements

CORNERSTONE ONDEMAND, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except par values)  
(unaudited)

	June 30, 2013	December 31, 2012
Assets		
Cash and cash equivalents	\$ 290,264	\$ 76,442
Accounts receivable, net	44,136	47,528
Deferred commissions	10,881	9,354
Prepaid expenses and other current assets	11,280	8,249
Total current assets	356,561	141,573
Capitalized software development costs, net	8,814	7,007
Property and equipment, net	11,557	7,947
Intangible assets, net	5,758	6,887
Goodwill	8,193	8,193
Other assets, net	6,312	227
Total Assets	\$ 397,195	\$ 171,834
Liabilities and Stockholders' Equity		
Liabilities:		
Accounts payable	\$ 11,052	\$ 4,849
Accrued expenses	13,522	14,986
Deferred revenue, current portion	92,399	87,759
Capital lease obligations, current portion	1,300	1,643
Debt, current portion	496	916
Other liabilities	3,653	3,885
Total current liabilities	122,422	114,038
Convertible notes, net	214,529	—
Other liabilities, non-current	3,395	3,592
Deferred revenue, net of current portion	2,641	4,493
Capital lease obligations, net of current portion	583	1,227
Other long-term debt, net of current portion	678	1,836
Total liabilities	344,248	125,186
Commitments and contingencies (Note 9)		
Stockholders' Equity:		
Common stock, \$0.0001 par value; 1,000,000 shares authorized, 51,358 and 50,689 shares issued and outstanding at June 30, 2013 and December 31, 2012	5	5
Additional paid-in capital	266,965	242,767
Accumulated deficit	(214,658)	(196,041)
Accumulated other comprehensive income (loss)	635	(83)
Total stockholders' equity	52,947	46,648
Total Liabilities and Stockholders' Equity	\$ 397,195	\$ 171,834

See accompanying notes to unaudited condensed consolidated financial statements.

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CORNERSTONE ONDEMAND, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share data)  
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue	\$44,346	\$26,718	\$82,003	\$50,720
Cost of revenue	13,164	7,890	24,416	14,734
Gross profit	31,182	18,828	57,587	35,986
Operating expenses:				
Sales and marketing	26,274	17,422	49,284	33,659
Research and development	5,232	3,431	9,651	6,524
General and administrative	7,530	5,792	16,096	11,746
Amortization of certain acquired intangible assets	251	237	502	237
Total operating expenses	39,287	26,882	75,533	52,166
Loss from operations	(8,105	) (8,054	) (17,946	) (16,180
Other income (expense):				
Interest expense	(505	) (94	) (584	) (237
Other, net	(209	) (420	) (222	) (181
Other income (expense), net	(714	) (514	) (806	) (418
Loss before income tax benefit	(8,819	) (8,568	) (18,752	) (16,598
Income tax benefit	136	334	135	252
Net loss	\$(8,683	) \$(8,234	) \$(18,617	) \$(16,346
Net loss per share, basic and diluted	\$(0.17	) \$(0.17	) \$(0.36	) \$(0.33
Weighted average common shares outstanding, basic and diluted	51,153	49,763	51,031	49,573

See accompanying notes to unaudited condensed consolidated financial statements.

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CORNERSTONE ONDEMAND, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (in thousands)  
 (unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Net loss	\$(8,683	) \$(8,234	) \$(18,617	) \$(16,346
Foreign currency translation adjustment, net of tax	5	158	718	2
Total comprehensive loss	\$(8,678	) \$(8,076	) \$(17,899	) \$(16,344

See accompanying notes to unaudited condensed consolidated financial statements.

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CORNERSTONE ONDEMAND, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

	Six Months Ended	
	June 30,	
	2013	2012
Cash flows from operating activities:		
Net loss	\$(18,617 )	\$(16,346 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,447	2,977
Accretion of debt discount and amortization of debt issuance costs	286	78
Unrealized foreign exchange loss	566	175
Stock-based compensation expense	8,346	4,981
Deferred income taxes	(378 )	(361 )
Changes in operating assets and liabilities:		
Accounts receivable	2,484	2,032
Deferred commissions	(1,810 )	(219 )
Prepaid expenses and other assets	(3,215 )	(586 )
Accounts payable	3,917	612
Accrued expenses	(1,448 )	(409 )
Deferred revenue	4,238	4,293
Other liabilities	70	413
Net cash used in operating activities	(1,114 )	(2,360 )
Cash flows from investing activities:		
Purchases of property and equipment	(2,377 )	(188 )
Capitalized software costs	(3,414 )	(2,462 )
Cash paid for acquisition, net of cash acquired	—	(12,428 )
Net cash used in investing activities	(5,791 )	(15,078 )
Cash flows from financing activities:		
Proceeds from issuance of convertible notes, net	246,043	—
Payments for convertible note hedges	(49,537 )	—
Proceeds from the issuance of warrants	23,225	—
Proceeds from issuance of debt	1,914	—
Repayment of debt	(3,776 )	(996 )
Principal payments under capital lease obligations	(987 )	(929 )
Proceeds from stock option and warrant exercises	4,140	1,041
Net cash provided by (used in) financing activities	221,022	(884 )
Effect of exchange rate changes on cash and cash equivalents	(295 )	(119 )
Net increase (decrease) in cash and cash equivalents	213,822	(18,441 )
Cash and cash equivalents at beginning of period	76,442	85,409
Cash and cash equivalents at end of period	\$290,264	\$66,968
Supplemental cash flow information:		
Cash paid for interest	\$162	\$163
Cash paid for income taxes	\$384	\$41
Non-cash investing and financing activities:		
Assets acquired under capital leases and other financing arrangements	\$88	\$2,852
Common stock issued for business acquisition	\$—	\$335
Capitalized assets financed by accounts payable	\$2,980	\$140

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Capitalized stock-based compensation	\$413	\$219
Deferred offering costs included in accrued expenses	\$379	\$—
See accompanying notes to unaudited condensed consolidated financial statements.		

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CORNERSTONE ONDEMAND, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company Overview

Cornerstone OnDemand, Inc. (“Cornerstone” or the “Company”) was incorporated on May 24, 1999 in the state of Delaware and began its principal operations in November 1999.

The Company is a leading global provider of comprehensive talent management solutions delivered as Software-as-a-Service (“SaaS”). The Company’s core solution consists of four integrated clouds for recruiting, learning management, performance management and extended enterprise. Customers may subscribe to one or more of the clouds.

The Company’s solutions are designed to enable organizations to meet the challenges they face in empowering and maximizing the productivity of their human capital. These challenges include developing employees throughout their careers, engaging all employees effectively, improving business execution, cultivating future leaders, and integrating with an organization’s extended enterprise of clients, vendors and distributors by delivering training, certification programs and other content. Management has determined that it operates in one segment as it only reports financial information on an aggregate and consolidated basis to its chief executive officer, who is the Company’s chief operating decision maker.

The Company also offers Cornerstone Small Business, a talent management solution for small businesses and Cornerstone for Salesforce, a cloud-based talent management solution developed on the Salesforce.com platform which allows organizations to provide access to sales enablement and just-in-time training from within Salesforce.

Office Locations

The Company is headquartered in Santa Monica, California and has offices in Auckland, Hong Kong, London, Mumbai, Munich, Madrid, Paris, Rome, Sydney and Tel Aviv.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with (i) United States generally accepted accounting principles (“GAAP”) for interim financial information and (ii) the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the financial statements include all adjustments (consisting of normal recurring adjustments) considered necessary for the fair statement of the interim periods presented. Results for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013, for any other interim period or for any other future year.

The condensed consolidated balance sheet at December 31, 2012 has been derived from the audited financial statements at that date, but does not include all of the disclosures required by GAAP.

The Company’s significant accounting policies were described in “Note 1. Summary of Significant Accounting Policies” in the Annual Report on Form 10-K for the year ended December 31, 2012. The Company follows the same accounting policies for interim reporting. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company’s consolidated financial statements and related notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2012.

Recent Accounting Pronouncements

In March 2013, the FASB issued new accounting guidance clarifying the accounting for the release of cumulative translation adjustment into net income when a company either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2013. The Company does not anticipate that the adoption of this guidance will have a significant impact on its financial position, results of operations or cash flows.



## 2. BUSINESS ACQUISITION

On April 5, 2012, the Company completed the acquisition of all of the issued and outstanding shares of Sonar Limited (“Sonar”), a New Zealand based SaaS talent management vendor serving small businesses worldwide.

### Unaudited Pro Forma Financial Information

The following table reflects the unaudited pro forma consolidated results of operations for the six months ended June 30, 2012 as if the Sonar acquisition had taken place on January 1, 2011, after giving effect to certain adjustments including the amortization of acquired intangible assets and the associated tax effect and the elimination of the Company’s and Sonar’s non-recurring acquisition-related expenses (in thousands):

	Six Months Ended June 30,	
	2013 Actual	2012 Pro Forma
Revenues	\$82,003	\$51,723
Net loss	\$(18,617 )	\$(16,028 )

The unaudited pro forma information presented does not purport to be indicative of the results that would have been achieved had the acquisition been consummated as of January 1, 2011 nor of the results which may occur in the future. The pro forma adjustments are based upon available information and certain assumptions that the Company believes are reasonable. The unaudited pro forma information does not include any adjustments for any restructuring activities, operating efficiencies or cost savings.

## 3. NET LOSS PER SHARE

The following table presents our basic and diluted loss per share (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net loss	\$(8,683 )	\$(8,234 )	\$(18,617 )	\$(16,346 )
Weighted-average shares of common stock outstanding	51,153	49,763	51,031	49,573
Net loss per share – basic and diluted	\$(0.17 )	\$(0.17 )	\$(0.36 )	\$(0.33 )

At June 30, 2013 and 2012, anti-dilutive shares excluded from the calculation of diluted net loss per share were (in thousands):

	June 30,	
	2013	2012
Options to purchase common stock and restricted stock units	7,099	6,830
Convertible notes	4,682	—
Common stock warrants	4,682	99
Shares issued for purchase consideration held in escrow	—	16
Common stock subject to repurchase right	—	20
Other restricted common stock	22	31
Total shares excluded from net loss per share	16,485	6,996

Under the treasury stock method, the convertible notes and common stock warrants will have a dilutive impact on net earnings per share when the average stock price for the period exceeds the conversion price for the convertible notes and the Company has net income attributable to common stockholders. See Note 6 of the Notes to Condensed Consolidated Financial Statements.

#### 4. INTANGIBLE ASSETS

The Company has finite-lived intangible assets which are amortized over the estimated useful lives on a straight line basis. The following table presents the gross carrying amount and accumulated amortization of finite-lived intangible assets as of June 30, 2013 and December 31, 2012 (in thousands):

	June 30, 2013			December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	\$3,800	\$ (1,174 )	\$ 2,626	\$3,800	\$ (700 )	\$ 3,100
Customer relationships	2,400	(742 )	1,658	2,400	(441 )	1,959
Domains/trademarks/tradenames	320	(198 )	122	320	(118 )	202
Software license rights	1,654	(610 )	1,044	1,654	(459 )	1,195
Non-compete agreements	610	(302 )	308	610	(179 )	431
Total	\$8,784	\$ (3,026 )	\$ 5,758	\$8,784	\$ (1,897 )	\$ 6,887

Total amortization expense from finite-lived intangible assets was \$0.6 million and \$1.1 million for the three and six months ended June 30, 2013, respectively, and \$0.5 million and \$0.6 million for the three and six months ended June 30, 2012, respectively. Amortization expense of \$0.3 million and \$0.6 million for the three and six months ended June 30, 2013, respectively, and \$0.3 million and \$0.3 million for the three and six months ended June 30, 2012, respectively, related to developed technology and software license rights was recorded in cost of revenues and the remainder in "Amortization of certain acquired intangible assets" in the accompanying Consolidated Statements of Operations.

The following table presents the Company's estimate of remaining amortization expense for each of the five succeeding fiscal years ending December 31 for finite-lived intangible assets that existed at June 30, 2013 (in thousands):

2013	\$ 1,134
2014	2,078
2015	1,840
2016	554
2017	145
Thereafter	7
Total	\$ 5,758

Estimated remaining amortization expense of \$0.4 million, \$1.2 million, \$1.2 million, \$0.4 million, and \$0.1 million is expected to be recorded in cost of revenue for 2013, 2014, 2015, 2016, and 2017 and thereafter, respectively. The remaining estimated amortization expense will be recorded in amortization of certain acquired intangible assets within operating expenses.

The Company evaluates the recoverability of its long-lived assets with finite useful lives, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Based on the assessment of various factors in connection with the preparation of the Company's first quarter financial statements, the Company does not believe there were any negative qualitative factors impacting the recoverability of the carrying values. There were no impairment charges related to identifiable intangible assets in the three and six months ended June 30, 2013 and the year ended December 31, 2012.

#### 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value represents the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. Observable inputs are based on market data obtained

from independent sources. The fair value hierarchy is based on the following three levels of inputs, of which the first two are considered observable and the last one is considered unobservable:

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Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access at the measurement date.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 – Unobservable inputs.

Assets and liabilities measured at fair value on a recurring basis include the following as of June 30, 2013 and December 31, 2012 (in thousands):

	June 30, 2013				December 31, 2012			
	Fair Value	Level 1	Level 2	Level 3	Fair Value	Level 1	Level 2	Level 3
Cash equivalents	\$271,251	\$271,251	\$—	\$—	\$51,521	\$51,521	\$—	\$—

At June 30, 2013 and December 31, 2012, cash equivalents of \$271.3 million and \$51.5 million, respectively, consisted of money market funds with original maturity dates of three months or less backed by U.S. Treasury bills. The convertible notes are shown in the accompanying consolidated balance sheets at its original issuance value, net of unamortized discount, and are not marked to market each period. The aggregate fair value of the convertible notes approximate the notes value as of June 30, 2013. The fair value of the convertible notes were estimated on the basis of quoted market prices of similar securities, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

## 6. DEBT

### Senior Convertible Notes

In June 2013, the Company issued senior convertible notes (the “Notes”) raising gross proceeds of \$253.0 million. The Notes are governed by an Indenture, dated June 17, 2013 (“Indenture”), between the Company and U.S. Bank National Association, as trustee. The Notes will mature on July 1, 2018, unless earlier repurchased or converted, and bear interest at a rate of 1.50% per year payable semi-annually in arrears on January 1 and July 1 of each year, commencing January 1, 2014.

The Notes are convertible at an initial conversion rate of 18.5046 shares of common stock per \$1,000 principal amount of Notes, which represents an initial conversion price of approximately \$54.04 per share, subject to adjustment for anti-dilutive issuances, voluntary increases in the conversion rate and make-whole adjustments upon a fundamental change. A fundamental change includes a change in control, delisting of the Company's stock and a liquidation of the Company. Upon conversion, the Company will deliver cash for the principal amount, and the Company has the right to settle any amounts in excess of the principal in cash or shares.

Prior to April 1, 2018, the Notes are only convertible upon satisfaction of certain conditions as follows:

during any calendar quarter after September 30, 2013, if the last reported sale price of common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

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

upon the occurrence of specified corporate events as defined in the Indenture.

Holders of the Notes may convert their Notes at anytime on or after April 1, 2018, until the close of business on the second scheduled trading day immediately preceding the maturity date.

The holders of the Notes may require the Company to repurchase all or a portion of their Notes at a cash repurchase price equal to 100% of the principal amount of the Notes being repurchased, plus accrued and unpaid interest, upon a fundamental change and events of default including non-payment of interest or principal and other obligations under the Indenture.



In accounting for the Notes at issuance, the Company separated the Notes into debt and equity components pursuant to the accounting standards for convertible debt instruments that may be fully or partially settled in cash upon conversion. The fair

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value of the debt component was estimated using an interest rate for nonconvertible debt, with terms similar to the Notes, excluding the conversion feature. 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 excess of the principal amount of the Notes over the fair value of the debt component was recorded as a debt discount and a corresponding increase in additional paid-in capital. The debt discount is accreted to interest expense over the term of the Notes using the interest method. The amount recorded to additional paid-in capital is not to be remeasured as long as it continues to meet the conditions for equity classification. Upon issuance of the \$253.0 million of Notes, the Company recorded \$214.3 million to debt and \$38.7 million to additional paid-in capital.

The Company incurred transaction costs of approximately \$7.3 million related to the issuance of the Notes. In accounting for these costs, the Company allocated the costs to the debt and equity components in proportion to the allocation of proceeds from the issuance of the Notes to such components. Transaction costs allocated to the debt component of \$6.2 million are deferred as an asset and amortized to interest expense over the term of the Notes. The transaction costs allocated to the equity component of \$1.1 million were recorded to additional paid-in capital. The transaction costs allocated to the debt component were recorded as deferred offering costs in other noncurrent assets. The net carrying amount of the liability component of the Notes as of June 30, 2013 consists of the following (in thousands):

Principal amount	\$253,000	
Unamortized debt discount	(38,471	)
Net carrying value	\$214,529	

The following table presents the interest expense recognized related to the Notes for the three months ended June 30, 2013 (in thousands):

Contractual interest expense at 1.5% per annum	\$137
Amortization of debt issuance costs	40
Accretion of debt discount	246
Total	\$423

The net proceeds from the Notes were approximately \$246.0 million after payment of the initial purchasers' offering expenses. The Company used approximately \$49.5 million of the net proceeds of the Notes offering to pay the cost of the Note Hedges described below, which was partially offset by \$23.2 million of the proceeds from the Company's sale of the Warrants also described below.

#### Note Hedges

Concurrent with the issuance of the Notes, the Company entered into note hedges ("Note Hedges") with certain bank counterparties, with respect to its common stock. The Company paid \$49.5 million for the Note Hedges. The Note Hedges cover approximately 4.7 million shares of the Company's common stock at a strike price of \$54.04 per share, and are exercisable by the Company upon conversion of the Notes. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential economic dilution upon conversion of the Notes in the event that the fair value per share of the Company's common stock at the time of exercise is greater than the conversion price of the Notes.

#### Warrants

Separately, the Company entered into warrant transactions, whereby it sold warrants to the same bank counterparties as the Note Hedges to acquire up to 4.7 million shares of the Company's common stock at a strike price of \$80.06 per share ("Warrants"), subject to anti-dilution adjustments. The Company received proceeds of \$23.2 million from the sale of the Warrants. The Warrants expire at various dates during 2018 and 2019. If the fair value per share of the Company's common stock exceeds the strike price of the Warrants, the Warrants will reduce diluted earnings per share to the extent that the calculation does not have an anti-dilutive effect.

The amounts paid and received for the Note Hedges and the Warrants have been recorded in additional paid-in capital. The fair value of the Note Hedges and the Warrants are not remeasured through earnings each reporting period.

## Silicon Valley Bank

In November 2012, the Company amended its SVB Credit Facility to allow for additional loan advances up to an aggregate of \$5.0 million for the purchase of equipment. In June 2013, concurrent with the issuance of the Notes, the Company repaid its total outstanding borrowings under the SVB Credit Facility in the amount of \$3.0 million. The SVB Credit Facility was extinguished upon the June 2013 repayment.

## Other Debt Arrangements

The Company entered into other debt arrangements with finance companies to finance the purchase of property and equipment and software. The total amounts outstanding under these arrangements were \$1.2 million and \$1.4 million as of June 30, 2013 and December 31, 2012, respectively.

## 7. STOCKHOLDERS' EQUITY AND STOCK-BASED AWARDS

## Stockholders' Equity

During the six months ended June 30, 2013, additional paid-in capital increased by \$24.2 million. The increase in additional paid-in capital was from proceeds received from the issuance of Warrants of \$23.2 million, recording of the note discount of \$38.7 million, exercises of stock options and warrants of \$4.1 million, and stock-based compensation of \$8.7 million offset by payments for the Note Hedges of \$49.5 million and an allocation of the Note issuance costs of \$1.1 million to equity.

## Stock-Based Awards

The following table summarizes the stock option activity for the six months ended June 30, 2013 (in thousands, except per share and term information):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, December 31, 2012	6,610	\$ 12.49	8.2	\$ 112,899
Granted	875	35.21		
Exercised	(647)	) 6.39		
Forfeited	(180)	) 23.85		
Outstanding, June 30, 2013	6,658	\$ 15.76	8.0	\$ 183,399

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Exercisable at June 30, 2013	2,932	\$ 8.71	7.2	\$ 101,430
Vested and expected to vest at June 30, 2013	6,552	15.67	8.0	181,041

Unrecognized compensation expense relating to stock options was \$36.7 million at June 30, 2013, which is expected to be recognized over a weighted-average period of 2.5 years.

The aggregate grant date fair value of stock options granted during the six months ended June 30, 2013 was \$15.3 million.

### Restricted Stock Awards

In connection with the acquisition of Sonar, the Company issued 31,164 restricted shares of its common stock, valued at approximately \$0.7 million, to certain Sonar shareholders who also became employees of the Company upon the acquisition. The vesting of the restricted shares is subject to continued employment, and the fair value of the restricted shares is being recognized as compensation expense over the 2 year vesting period. As of June 30, 2013, 9,350 of the issued shares were vested.

### Restricted Stock Units

At June 30, 2013, 441,323 shares of the Company's common stock subject to unvested restricted stock units were outstanding. Unrecognized compensation expense related to shares of the Company's common stock subject to unvested restricted stock units was \$4.7 million at June 30, 2013, which is expected to be recognized as expense over the weighted-average period of 1.6 years.

### Performance Based Options and Units

The Company recognized compensation expense related to performance based awards of \$0.1 million and \$0.1 million for the three and six months ended June 30, 2013. Unrecognized compensation expense related to nonvested performance based options and restricted stock units was \$0.6 million at June 30, 2013, based on the probable performance target at that date, which is expected to be recognized as expense over the weighted-average period of 2.5 years.

### Stock-Based Compensation

Stock-based compensation expense related to stock options, restricted stock and restricted stock units is included in the following line items in the accompanying Consolidated Statement of Operations for the three and six months ended June 30, 2013 and 2012 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Cost of revenue	\$472	\$520	\$900	\$1,011
Sales and marketing expense	1,964	648	3,648	1,126
Research and development expense	428	196	751	340
General and administrative expense	1,483	1,118	3,047	2,504
Total	\$4,347	\$2,482	\$8,346	\$4,981

## 8. INCOME TAXES

The Company's income tax benefit was approximately \$0.1 million and \$0.1 million and the effective income tax rate was 1.6% and 0.7% for the three and six months ended June 30, 2013, respectively, as compared to an income tax benefit of \$0.3 and \$0.3 million and the effective income tax rate of 3.9% and 1.5% for the three and six months ended June 30, 2012, respectively. The income tax benefit relates to the amortization of deferred tax liabilities assumed in connection with the Sonar acquisition partially offset by foreign and state income taxes. The Company's effective tax rate differs from the statutory rate primarily due to the amortization of deferred tax liabilities assumed as part of the Sonar acquisition, the change in the valuation allowance on the Company's deferred tax assets and foreign income taxes.

During the quarter ended June 30, 2013, in connection with the Notes and Note Hedges, the Company recorded a deferred tax liability of \$15.7 million for the note discount and a deferred tax asset of \$19.9 million for the Note Hedges with corresponding adjustments to additional paid-in capital. The net deferred tax asset of \$4.2 million, was offset by a valuation allowance as realization is not more likely than not, which was also recorded in additional paid-in capital.

The Company has incurred annual losses since inception in the U.S. and U.K. As a result of these losses, the Company recorded valuation allowances on the net deferred tax assets of the Company's U.S. and U.K. deferred tax assets and does not anticipate recording an income tax benefit related to these deferred tax assets. The Company will reassess the

realization of deferred tax assets each reporting period and will be able to reduce the valuation allowance to the extent that the financial results of these operations improve and it becomes more likely than not that the deferred tax assets are realizable.

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The Company is subject to U.S. federal income tax, state income tax and various foreign income taxes. The Company is subject to examination for years after 2009 and 2008 for its U.S. federal income tax returns and state income tax returns, respectively. The Company is subject to examination by various foreign jurisdictions for years after 2007. The Internal Revenue Service has selected for examination the U.S. federal income tax return for the year ended December 31, 2011. The Company does not believe the examination will have a material impact on the Company's financial condition or results of operation. The Company believes it has adequately reserved for its uncertain tax positions; there is no assurance, however, that taxing authorities will not propose adjustments that are more or less than the Company's expected outcome. In addition, the Company does not expect the change in uncertain tax positions to have a material impact on its financial position, results of operations or liquidity.

## 9. COMMITMENTS AND CONTINGENCIES

### Guarantees and Indemnifications

The Company has made guarantees and indemnities under which it may be required to make payments to a guaranteed or indemnified party in relation to certain transactions, including revenue transactions in the ordinary course of business. In connection with certain facility leases, the Company has agreed to indemnify its lessors for certain claims arising from the facility or the lease. The Company is obligated to indemnify its directors and officers to the maximum extent permitted under the laws of the State of Delaware. However, the Company has a directors and officers insurance policy that may reduce its exposure in certain circumstances and may enable it to recover a portion of future amounts that may be payable, if any. The duration of the guarantees and indemnities varies and, in many cases, is indefinite but subject to statutes of limitations. To date, the Company has made no payments related to these guarantees and indemnities. The Company estimates the fair value of its indemnification obligations as insignificant based on this history and the Company's insurance coverage and therefore has not recorded any liability for these guarantees and indemnities in the accompanying consolidated balance sheets.

### Lease Commitments

During the six months ended June 30, 2013, the Company amended its Santa Monica office lease to increase its office space. Additional obligations under the amended lease are approximately \$0.1 million for 2013, \$0.6 million for 2014, \$0.7 million for 2015, \$0.7 million for 2016, \$0.7 million for 2017, and \$0.5 million for 2018. The Company also entered into various other operating lease agreements with obligations of approximately \$0.2 million for 2013, \$0.2 million for 2014, and \$0.2 million for 2015 and thereafter.

### Other Contractual Obligations

In June 2013, the Company issued senior convertible notes (the "Notes") raising gross proceeds of \$253.0 million. The Notes are governed by an Indenture, dated June 17, 2013, between the Company and U.S. Bank National Association, as trustee. The Notes will mature on July 1, 2018, unless earlier repurchased or converted, and bear interest at a rate of 1.50% per year payable semi-annually in arrears on January 1 and July 1 of each year, commencing January 1, 2014.

### Litigation

During 2012, the Company received an unfavorable ruling in arbitration related to an employment matter. Based on this ruling, the Company has estimated the probable loss for this matter, including both the award and estimated plaintiff attorneys' fees, to be approximately \$2.3 million and accrued this amount within other current liabilities. The Company determined that insurance recovery for this loss is probable, and has recorded a related receivable in other current assets for this matter. In January 2013, the Company filed a motion to vacate the award, and the hearing has been scheduled for September 16, 2013. Based on the above, the Company believes this matter will not have a material adverse effect on the Company's business, operating results, cash flows and financial condition.

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. If the Company determines that it is probable that a loss has been incurred and the amount is reasonably estimable, the Company will record a liability. Except for the matter described above, the Company has determined that it does not have a potential liability related to any legal proceedings or claims that would individually or in the aggregate materially adversely affect its financial conditions or operating results.

## 10. SUBSEQUENT EVENTS

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During July and August 2013, the Compensation Committee of the Board of Directors granted stock options to purchase 685,468 shares of the Company's common stock at a weighted-average exercise price of \$44.29 per share. The stock options

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vest over four years. During July 2013, the Compensation Committee of the Board of Directors granted 115,140 shares of the Company's common stock subject to restricted stock units which vest annually over four years. On July 31, 2013, the Company entered into an agreement with a third party service provider whereby the Company has committed to provide implementation services. The commitments total approximately \$0.3 million in 2013, \$0.7 million in 2014, and \$0.3 million in 2015.

## ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are any statements that look to future events and consist of, among other things, statements regarding our business strategies; anticipated future operating results and operating expenses; our ability to attract new clients to enter into subscriptions for our solution; our ability to service those clients effectively and induce them to renew and upgrade their deployments of our solution; our ability to expand our sales organization to address effectively the new industries, geographies and types of organizations we intend to target; our ability to accurately forecast revenue and appropriately plan our expenses; market acceptance of enhanced solutions; alternate ways of addressing learning and talent management needs or new technologies generally by us and our competitors; continued acceptance of SaaS as an effective method for delivering learning and talent management solutions and other business management applications; the attraction and retention of qualified employees and key personnel; our ability to protect and defend our intellectual property; costs associated with defending intellectual property infringement and other claims; events in the markets for our solution and alternatives to our solution, as well as in the United States and global markets generally; future regulatory, judicial and legislative changes in our industry; and changes in the competitive environment in our industry and the markets in which we operate. In addition, forward-looking statements also consist of statements involving trend analyses and statements including such words as "may," "believe," "could," "anticipate," "would," "might," "plan," "expect," and similar expressions or the negative of such terms or other comparable terminology. These forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q and are subject to business and economic risks. As such, our actual results could differ materially from those set forth in the forward-looking statements as a result of the factors set forth below in Part II, Item 1A, "Risk Factors," and in our other reports filed with the Securities and Exchange Commission. We assume no obligation to update the forward-looking statements to reflect events that occur or circumstances that exist after the date on which they were made. The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.

### Overview

We are a leading global provider of a comprehensive talent management solutions delivered as software-as-a-service, or SaaS. We enable organizations to meet the challenges they face in empowering their people and maximizing the productivity of their human capital. These challenges include developing employees throughout their careers, engaging all employees effectively, improving business execution, cultivating future leaders and enabling an organization's extended enterprise of clients, vendors and distributors by delivering training, certification programs and other content.

Our core solution is a comprehensive and integrated cloud-based suite consisting of four integrated clouds for recruiting, learning, performance, and extended enterprise. Clients can purchase these clouds individually and easily add and integrate additional clouds at any time. We offer a number of cross-cloud tools for analytics and reporting, employee profile management, employee on-boarding and e-learning content aggregation. We also provide consulting services for configuration and training for our core solution as well as third-party e-learning content for use with the solution. We target our sales and marketing efforts for these four integrated clouds to large and mid-sized clients with 500 or more employees, and our core solution can be used in multiple industry vertical segments. After the initial purchase of our core solution, we continue to market and sell to our existing clients, who may renew their subscriptions, add additional clouds, broaden the deployment of the solution across their organizations and increase usage of the solution over time. We currently have over 1,400 clients who use our core solution to empower over 12 million users across 190 countries and 41 languages. The number of clients using our core solution has grown from



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105 at December 31, 2007 to 481 at December 31, 2010, to 805 at December 31, 2011, to 1,237 at December 31, 2012 and to 1,411 at June 30, 2013.

In addition to our core solution, we also offer Cornerstone Small Business, or CSB, a cloud-based talent management solution that is targeted to clients with less than 500 employees. We also offer Cornerstone for Salesforce, a cloud-based talent management solution developed natively on the Salesforce.com platform which allows organizations to provide seamless access to sales enablement and just-in-time training from within Salesforce. The CSB and Cornerstone for Salesforce solutions did not have a significant impact on our financial results and key metrics for the three months ended June 30, 2013 and are not expected to have a significant impact for the year ending December 31, 2013. We currently do not include the number of clients

and users of our CSB and Cornerstone for Salesforce solutions in our client and user key metrics as we believe the client and user count metrics for our core solution gives a better indication of our overall performance.

We founded our business in 1999 to improve access to education through the distribution of online educational content to individuals, small businesses and large corporations. Our distribution model was built using Internet technologies that are now known as software-as-a-service. When the Internet “bubble” burst in 2000, we focused on corporations that needed tools to manage compliance and on-boarding of employees as well as to link learning to employee performance, leadership development and knowledge management. As a result of our work with clients to address their particular challenges, we had as early as 2001 developed the foundation for a comprehensive, cloud-based talent management solution that included functionality for learning and performance management. In 2006, we added our extended enterprise functionality, which helps clients extend learning and talent management to their customers, vendors and distributors. During the first quarter of 2012, we added our Recruiting Cloud, which supports the modern ways that businesses source, recruit, hire and onboard new employees.

Global 500 companies were among our first clients. In our early years, we focused primarily on building our account management and support capabilities to be able to service these large clients more effectively. Sales were initially constrained by the resistance of some large corporations to purchase SaaS solutions. By the mid-2000s, however, our market opportunity increased significantly with both the adoption of SaaS solutions generally by large enterprises and the market’s recognition of talent management as a distinct industry.

In response to these positive trends, we raised our first round of institutional venture capital in May 2007. We used this capital to serve clients across multiple industries, geographies and enterprise types by increasing the number of our direct sales personnel, both domestically and internationally, and by expanding our indirect channels through distribution relationships. Between December 31, 2007 and June 30, 2013, our number of users increased from 859,000 to over 12 million.

We generate most of our revenue from the sale of our solutions pursuant to multi-year client agreements. Our sales processes are typically competitive and sales cycles generally vary in duration from two to nine months depending on the size of the potential client. We price our core solution based on the number of clouds purchased and the permitted number of users with access to each cloud. Client agreements for our core solution typically have terms of three years. We also generate revenue from consulting services for configuration, training, and consulting, as well as from the resale or hosting of third-party e-learning content.

We sell our solutions through our direct sales teams and, to a lesser extent, indirectly through our distributors. We intend to continue to invest in our direct sales and distribution activities to address our market opportunity.

We generally recognize revenue from subscriptions ratably over the term of the client agreement and revenue from consulting services as the services are performed. In certain instances, our clients request enhancements to the underlying features and functionality of our core solution, and in these instances, revenue from subscriptions is recognized over the remaining term of the agreement once the additional features are delivered to the client. We generally invoice our clients a portion of the annual subscription fees upfront for multi-year subscriptions and upfront for consulting services. For amounts not invoiced in advance for multi-year subscriptions or consulting services, we invoice under various terms over the subscription and service periods. We record amounts invoiced for annual subscription periods that have not occurred or services that have not been performed as deferred revenue on our balance sheet. With the growth in the number of clients, our net revenue has grown to \$44.3 million and \$82.0 million for the three and six months ended June 30, 2013, respectively, from \$26.7 million and \$50.7 million for the three and six months ended June 30, 2012, respectively.

We have historically experienced seasonality in terms of when we enter into client agreements. We sign a significantly higher percentage of agreements with new clients, as well as renewal agreements with existing clients, in the fourth quarter of each year. In addition, within a given quarter, we sign a large portion of these agreements during the last month, and often the last two weeks, of that quarter. We believe this seasonality is driven by several factors, most notably the tendency of procurement departments at our enterprise clients to purchase technology at the end of a quarter or calendar year, possibly in order to use up their available quarterly or annual funding allocations, or to be able to deploy new talent management capabilities prior to the beginning of a new financial or performance period. As the terms of most of our client agreements are measured in full year increments, agreements initially entered into the

fourth quarter or last month of any quarter will generally come up for renewal at that same time in subsequent years. This seasonality is reflected to a much lesser extent, and sometimes is not immediately apparent, in our revenue, due to the fact that we recognize subscription revenue over the term of the client agreement, which is generally three years. In addition, this seasonality is reflected in changes in our deferred revenue balance, which generally is impacted by the timing in which we enter into agreements with new clients, the timing of when we invoice new clients, the timing in which we invoice existing clients for annual subscription periods, and the timing in which we recognize revenue. We expect this seasonality to continue in the future, which may cause fluctuations in certain of our operating results and financial metrics, and thus limit our ability to predict future results.

We believe the market for talent management remains large and underpenetrated, providing us with significant growth opportunities. We expect businesses and other organizations to continue to increase their spending on talent management solutions in order to maximize productivity of their employees, manage changing workforce demographics and ensure compliance with global regulatory requirements. Historically, many of these software solutions have been human resource applications running on hardware located on organizations' premises. However, we believe that just as organizations have increasingly chosen SaaS solutions for business applications such as sales force management, they are also increasingly adopting SaaS talent management solutions.

We have focused on growing our business to pursue what we believe is a significant market opportunity, and we plan to continue to invest in building for growth. As a result, we expect our cost of revenue and operating expenses to increase in future periods. Sales and marketing expenses are expected to increase, as we continue to expand our direct sales teams, increase our marketing activities, and grow our international operations. Research and development expenses are expected to increase as we improve the existing functionality for our solutions. We also believe that we must invest in maintaining a high degree of client service and support that is critical for our continued success. We plan to continue our policy of implementing best practices across our organization, expanding our technical operations and investing in our network infrastructure and services capabilities in order to support continued future growth. We also expect to incur additional general and administrative expenses as a result of both our growth and our continued transition to operating as a public company. In addition, to the extent that we make additional strategic acquisitions in the future, like our acquisition of Sonar, our investments in operations may increase.

Our quarterly operating results have fluctuated in the past and may continue to fluctuate in the future based on a number of factors, many of which are beyond our control. In addition to those in the "Risk Factors" section of this Quarterly Report on Form 10-Q, such factors include:

- our ability to attract new clients;
- the timing and rate at which we enter into agreements for our solutions with new clients;
- the timing and duration of our client implementations, which is often outside of our direct control, and our ability to provide resources for client implementations and consulting projects;
- the extent to which our existing clients renew their subscriptions for our solutions and the timing of those renewals;
- the extent to which our existing clients purchase additional clouds or add incremental users;
- the extent to which our clients request enhancements to underlying features and functionality of our solutions and the timing for us to deliver the enhancements to our clients;
- changes in the mix of our sales between new and existing clients;
- changes to the proportion of our client base that is comprised of enterprise or mid-sized organizations;
- seasonal factors affecting the demand for our solutions;
- the timing of our client implementations;
- our ability to manage growth, including in terms of new clients, additional users and new geographies;
- the timing and success of competitive solutions offered by our competitors;
- changes in our pricing policies and those of our competitors; and
- general economic and market conditions.

One or more of these factors may cause our operating results to vary widely. As such, we believe that our quarterly results of operations may vary significantly in the future and that period-to-period comparisons of our operating results may not be meaningful and should not be relied upon as an indication of future performance.

#### Metrics

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

**Revenues.** We generally recognize subscription revenue over the contract period, and as a result of our revenue recognition policy and the seasonality of when we enter into new client agreements, revenue from client agreements signed in the current period may not be fully reflected in the current period. As a result, revenue increases period over period are primarily from contracts that existed prior to the beginning of that period.

**Bookings.** Under our revenue recognition policy, we generally recognize subscription revenue from our client agreements ratably over the terms of those agreements. For this reason, the major portion of our revenue for a period

will be from client agreements signed in prior periods rather than from new business activity during

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the current period. In order to assess our business performance with a metric that more fully reflects current period business activity, we track bookings, which is a non-GAAP financial measure we define as the sum of revenue and the change in the deferred revenue balance for the period. We include changes in the deferred revenue balance to calculate bookings so it better reflects new business activity in the period as evidenced by prepayments or billings under our billing policies arising from acquisition of new clients, sales of additional clouds to existing clients, the addition of incremental users by existing clients and client renewals. Bookings are affected by our billing terms, and any changes in those billing terms may shift bookings between periods. Due to the seasonality of our sales, bookings growth is inconsistent from quarter to quarter throughout a calendar year. For a reconciliation of bookings to revenue, please see “Results of Operations – Revenue and Metrics.”

**Number of clients.** We believe that our ability to expand our client base is an indicator of our market penetration and the growth of our business as we continue to invest in our direct sales teams and distributors. Our client count includes contracted clients for any combination of the four integrated clouds for our core solution as of the end of the period and excludes clients of our CSB and Cornerstone for Salesforce solutions.

**Number of users.** Since our clients generally pay fees based on the number of users of our solutions within their organizations, we believe the total number of users is an indicator of the growth of our business. Our user count includes active users for our core solution and excludes users of our CSB and Cornerstone for Salesforce solutions.

#### Key Components of Our Results of Operations

##### Sources of Revenue and Revenue Recognition

Our solutions are designed to enable organizations to meet the challenges they face in maximizing the productivity of their human capital. We generate revenue from the following sources:

**Subscriptions to Our Solutions.** Clients pay subscription fees for access to our solutions for a specified period of time, typically three years for our core solution or monthly, annually, or three-year periods for our CSB and Cornerstone for Salesforce solutions. Fees are based on a number of factors, including the number of users having access to a solution. We generally recognize revenue from subscriptions ratably over the term of the agreements.

**Consulting Services.** We offer our clients assistance in implementing our solutions and optimizing their use.

Consulting services include application configuration, system integration, business process re-engineering, change management and training services. Services are billed either on a time-and-material or a fixed-fee basis. These services are generally purchased as part of a subscription arrangement and are typically performed within the first several months of the arrangement. Clients may also purchase consulting services at any other time. Our consulting services are performed by us directly or by third-party service providers we engage. Clients may also choose to perform these services themselves or engage their own third-party service providers. We generally recognize revenue from fixed fee consulting services using the proportional performance method over the period the services are performed and as time is incurred for time-and-material arrangements.

**E-learning Content.** We resell third-party on-line training content, which we refer to as e-learning content, to our clients. We also host other e-learning content provided by our clients. We generally recognize revenue from the resale of e-learning content as it is delivered and recognize revenue from hosting as the hosting services are provided.

Our client agreements generally include both a subscription to access our solutions and related consulting services, and may also include e-learning content. Our agreements generally do not contain any cancellation or refund provisions other than in the event of our default.

##### Cost of Revenue

Cost of revenue consists primarily of costs related to hosting our solutions; personnel and related expenses, including stock-based compensation, for network infrastructure, IT support, consulting services and on-going client support; payments to external service providers; amortization of capitalized software costs, amortization of developed technology and software license rights; licensing fees; and referral fees. In addition, we allocate a portion of overhead, such as rent, IT costs, depreciation and amortization and employee benefits costs, to cost of revenue based on headcount. The costs associated with providing consulting services are significantly higher as a percentage of revenue than the costs associated with providing access to our solutions due to the labor costs to provide the consulting services.



## Operating Expenses

Our operating expenses are as follows:

**Sales and Marketing.** Sales and marketing expenses consist primarily of personnel and related expenses for our sales and marketing staff, including salaries, benefits, bonuses, stock-based compensation and commissions; costs of marketing and promotional events, corporate communications, online marketing, product marketing and other brand-building activities; and allocated overhead.

We intend to continue to invest in sales and marketing and expect spending in these areas to increase as we continue to expand our business both domestically and internationally. We expect sales and marketing expenses to continue to be among the most significant components of our operating expenses.

**Research and Development.** Research and development expenses consist primarily of personnel and related expenses for our research and development staff, including salaries, benefits, bonuses and stock-based compensation; the cost of certain third-party service providers; and allocated overhead. Research and development costs, other than software development costs qualifying for capitalization, are expensed as incurred.

We have focused our research and development efforts on continuously improving our solutions. We believe that our research and development activities are efficient because we benefit from maintaining a single software code base for each of our solutions. We expect research and development expenses to increase in absolute dollars in the future, as we scale our research and development department and expand our network infrastructure.

**General and Administrative.** General and administrative expenses consist primarily of personnel and related expenses for administrative, legal, finance and human resource staffs, including salaries, benefits, bonuses and stock-based compensation; professional fees; insurance premiums; other corporate expenses; and allocated overhead. We expect our general and administrative expenses to increase as we continue to expand our operations.

**Amortization of Certain Acquired Intangible Assets.** Amortization of certain acquired intangibles consists of amortization of Sonar acquisition-related intangibles including customer relationships, non-compete agreements, patents, trade names and trademarks. We also record amortization of developed technology and software license rights in cost of revenues.

## Other Income (Expense)

**Interest Expense.** Interest expense consists primarily of interest expense from borrowings under our credit facility, our promissory notes and convertible debt; capital lease payments; accretion of debt discount; and amortization of debt issuance costs. We recognize accretion of debt discount and amortization of interest costs using the effective interest method. We expect our interest expense to increase significantly from accretion of debt discount, amortization of deferred financing costs and schedule interest costs as a result of our June 2013 issuance of \$253 million of convertible notes.

**Other, Net.** Other, net consists of income and expense associated with fluctuations in foreign currency exchange rates and other non-operating expenses. We expect interest income (expense) and other income (expense) to vary depending on the movement in foreign currency exchange rates and the related impact on our foreign exchange gain (loss) and the nature of various non-operating expenses.

## Income Tax Provision

The income tax provision is related to certain foreign and state income taxes, and the amortization of deferred tax liabilities assumed as part of the Sonar acquisition which occurred in 2012. As we have incurred operating losses in the U.S. and U.K. in all annual periods to date and recorded a full valuation allowance against our U.S. and U.K. net deferred tax assets, we have not historically recorded a provision for U.S. and U.K. income taxes. Certain foreign subsidiaries and branches of ours provide intercompany services and are compensated on a cost-plus basis, and therefore, have incurred liabilities for foreign income taxes in their respective jurisdictions.

## Critical Accounting Policies and Estimates

Information with respect to our critical accounting policies which we believe have the most significant effect on our reported results and require subjective or complex judgments of management are contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 1, 2013.





As of June 30, 2013, there have been no material changes to our critical accounting policies since December 31, 2012.

#### Recent Accounting Pronouncements

For information regarding recent accounting pronouncements, refer to Note 1 of Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

#### Results of Operations

The following table sets forth our results of operations for each of the periods indicated (in thousands). The period-to-period comparison of financial results is not necessarily indicative of future results.

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Revenue	\$44,346	\$26,718	\$82,003	\$50,720
Cost of revenue	13,164	7,890	24,416	14,734
Gross profit	31,182	18,828	57,587	35,986
Operating expenses:				
Sales and marketing	26,274	17,422	49,284	33,659
Research and development	5,232	3,431	9,651	6,524
General and administrative	7,530	5,792	16,096	11,746
Amortization of acquired intangibles	251	237	502	237
Total operating expenses	39,287	26,882	75,533	52,166
Loss from operations	(8,105)	(8,054)	(17,946)	(16,180)
Other income (expense):				
Interest income (expense)	(505)	(94)	(584)	(237)
Other, net	(209)	(420)	(222)	(181)
Loss before income tax benefit	(8,819)	(8,568)	(18,752)	(16,598)
Income tax benefit	136	334	135	252
Net loss	\$(8,683)	\$(8,234)	\$(18,617)	\$(16,346)

The following table sets forth our revenue and key metrics that we use to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions:  
Revenue and Metrics

	At or For Three Months Ended		At or For Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Revenue (in thousands)	\$44,346	\$26,718	\$82,003	\$50,720
Bookings (in thousands)	\$48,852	\$31,534	\$84,791	\$55,493
Number of clients	1,411	1,001	1,411	1,001
Number of users (in thousands)	12,259	9,404	12,259	9,404

Revenue increased \$17.6 million, or 66%, for the three months ended June 30, 2013 as compared to the same period in 2012. The increase was primarily the result of a \$15.6 million increase in revenue from existing clients, that is, revenue from client agreements that were entered into prior to April 1, 2013. In addition, revenue increased by \$2.0 million from the acquisition of new clients during the three months ended June 30, 2013.

Revenue generated in the United States was \$31.4 million, or 71%, of total revenue for the three months ended June 30, 2013 as compared to \$18.5 million, or 69%, for the same period in 2012, a 70% increase. Revenue generated outside of the United States was \$12.9 million, or 29%, of total revenue for the three months ended June 30, 2013 as compared to \$8.2 million, or 31%, for the same period in 2012, a 57% increase.



Revenue increased \$31.3 million, or 62%, for the six months ended June 30, 2013 as compared to the same period in 2012. The increase in revenue was primarily the result of \$24.2 million increase in revenue from existing clients and a \$7.1 million increase in revenue resulting from the acquisition of new clients during the six months ended June 30, 2013, as compared to revenue in the six months ended June 30, 2012 from existing clients at that period and new client acquisitions during that period, respectively.

Revenue generated in the United States was \$57.6 million, or 70%, of total revenue for the six months ended June 30, 2013 as compared to \$35.3 million, or 70%, for the same period in 2012, resulting in a 63% increase. Revenue generated outside of the United States was \$24.4 million, or 30%, of total revenue for the six months ended June 30, 2013 as compared to \$15.4 million, or 30%, for the same period in 2012, resulting in a 59% increase.

Bookings increased 55% and 53%, respectively, for the three and six months ended June 30, 2013 as compared to the same periods in 2012, reflecting the increase in deferred revenue at June 30, 2013 from March 31, 2013 compared to the same period in 2012, and an increase in deferred revenue at June 30, 2013 from December 31, 2012 compared to June 30, 2012 from December 31, 2011. The growth rates for revenue and bookings are not correlated with each other in a given period due to the seasonality of when we enter into client agreements, the varied timing of billings, the recognition in most cases of subscription revenue on a straight-line basis over the term of each client agreement, and the recognition of consulting revenue which is generally based on proportional performance over the period the services are performed.

Our number of clients grew 41% at June 30, 2013 compared to June 30, 2012. Our number of users increased 30% at June 30, 2013 compared to June 30, 2012.

As discussed above under the heading “Metrics,” bookings is a non-GAAP financial measure defined as the sum of revenue and the change in the deferred revenue balance for the period. Our management uses bookings in analyzing its financial results and believes it is useful to investors, as a supplement to the corresponding GAAP measure, in evaluating our ongoing operational performance and trends and in comparing our financial measures with other companies in the same industry. However, it is important to note that other companies, including companies in our industry, may calculate bookings differently or not at all, which may reduce its usefulness as a comparative measure. The following table presents a reconciliation of revenue to bookings for each of the periods presented (in thousands):

	Deferred Revenue Balance	Three Months Ended June 30, 2013
Revenue		\$44,346
Deferred revenue at March 31, 2013	\$90,534	
Deferred revenue at June 30, 2013	95,040	
Change in deferred revenue		4,506
Bookings		\$48,852
	Deferred Revenue Balance	Three Months Ended June 30, 2012
Revenue		\$26,718
Deferred revenue at March 31, 2012	\$55,837	
Deferred revenue at June 30, 2012	60,653	
Change in deferred revenue		4,816
Bookings		\$31,534

	Deferred Revenue Balance	Six Months Ended June 30, 2013
Revenue		\$82,003
Deferred revenue at December 31, 2012	\$92,252	
Deferred revenue at June 30, 2013	95,040	
Change in deferred revenue		2,788
Bookings		\$84,791
	Deferred Revenue Balance	Six Months Ended June 30, 2012
Revenue		\$50,720
Deferred revenue at December 31, 2011	\$55,880	
Deferred revenue at June 30, 2012	60,653	
Change in deferred revenue		4,773
Bookings		\$55,493

We believe our revenue growth is a result of our continued investment in and development of our direct sales and sales support teams. We believe this investment has enabled us to achieve greater sales coverage and better sales execution, as well as increased marketing activities, which we believe have increased brand awareness and created higher demand for our solution. We have also continued to enhance our comprehensive solution, which we believe has encouraged existing clients to add additional clouds and users.

#### Cost of Revenue and Gross Margin

	Three Months Ended June 30,		Six Months Ended June 30,		
	2013	2012	2013	2012	
	(dollars in thousands)				
Cost of revenue	\$13,164	\$7,890	\$24,416	\$14,734	
Gross profit	\$31,182	\$18,828	\$57,587	\$35,986	
Gross margin	70	% 71	% 70	% 71	%

Cost of revenue increased \$5.3 million, or 67%, for the three months ended June 30, 2013 as compared to the same period in 2012. The increase in cost of revenues related to \$2.0 million in outsourced consulting services as we used more third parties to perform services on our behalf, and \$1.7 million in increased employee-related costs due to higher headcount, in each case to service our existing clients and support our continued growth. The remaining increase relates to other various costs associated with generating revenues from our clients.

Cost of revenue increased \$9.7 million, or 66%, for the six months ended June 30, 2013 as compared to the same period in 2012. The increase in cost of revenue related to \$4.1 million in increased employee-related costs due to higher headcount and \$2.7 million in increased costs related to outsourced consulting services, in each case to service our existing clients and support our continued growth. The remaining increase relates to other various direct costs associated with generating revenues from our clients.

#### Sales and Marketing

	Three Months Ended June 30,		Six Months Ended June 30,		
	2013	2012	2013	2012	
	(dollars in thousands)				
Sales and marketing	\$26,274	\$17,422	\$49,284	\$33,659	
Percent of revenue	59	% 65	% 60	% 66	%

Sales and marketing expenses increased \$8.9 million, or 51%, for the three months ended June 30, 2013 as compared to the same period in 2012. The increase was a result of the growth of our sales force and increase in marketing programs to address additional opportunities in new and existing markets. Total headcount in sales and marketing at June 30, 2013 increased

compared to June 30, 2012, contributing to an increase in employee-related costs of \$5.1 million. In addition, we incurred increased costs associated with marketing programs and events of \$1.4 million, increased travel costs associated with our direct sales teams of \$1.0 million, and increased allocated overhead costs, such as rent, IT costs, and depreciation and amortization, of \$0.5 million. The absolute dollar increase of sales and marketing expenses are expected to increase with the growth of our company.

Sales and marketing expenses increased \$15.6 million, or 46%, for the six months ended June 30, 2013 as compared to the same period in 2012. The increase was a result of the growth of our sales force and increase in marketing programs to address additional opportunities in new and existing markets. Total headcount in sales and marketing at June 30, 2013 increased compared to June 30, 2012, contributing to an increase in employee-related costs of \$9.9 million. In addition, we incurred increased costs associated with marketing programs and events of \$2.0 million, increased travel costs associated with our direct sales teams of \$1.7 million, and increased allocated overhead costs, such as rent, IT costs, and depreciation and amortization, of \$0.8 million. The absolute dollar increase of sales and marketing expenses are expected to increase with the growth of our company.

#### Research and Development

	Three Months Ended		Six Months Ended		
	June 30, 2013	2012	June 30, 2013	2012	
	(dollars in thousands)				
Research and development	\$5,232	\$3,431	\$9,651	\$6,524	
Percent of revenue	12	% 13	% 12	% 13	%

Research and development expenses increased by \$1.8 million, or 52%, for the three months ended June 30, 2013 as compared to the same period in 2012. The increase was a result of our continued investment in research and development headcount at June 30, 2013 compared to June 30, 2012 to maintain and improve the existing functionality of our solutions. As a result, we incurred increased employee-related costs of \$1.4 million. The remaining increase relates to allocated overhead costs.

Research and development expenses increased by \$3.1 million, or 48%, for the six months ended June 30, 2013 as compared to the same period in 2012. The increase was a result of our continued investment in research and development headcount at June 30, 2013 compared to June 30, 2012 to maintain and improve the existing functionality of our solutions. As a result, we incurred increased employee-related costs of \$2.6 million. The remaining increase relates to allocated overhead costs.

We capitalize a portion of our software development costs related to the development and enhancements of our solution, which is then amortized to cost of revenue. The timing of our capitalizable development and enhancement projects may affect the amount of development costs expensed in any given period. We capitalized \$1.8 million and \$1.9 million of software development costs and amortized \$1.0 million and \$0.7 million in the three months ended June 30, 2013 and June 30, 2012, respectively, and capitalized \$3.7 million and \$3.1 million and amortized \$1.9 million and \$0.6 million in the six months ended June 30, 2013 and June 30, 2012, respectively.

#### General and Administrative

	Three Months Ended		Six Months Ended		
	June 30, 2013	2012	June 30, 2013	2012	
	(dollars in thousands)				
General and administrative	\$7,530	\$5,792	\$16,096	\$11,746	
Percent of revenue	17	% 22	% 20	% 23	%

General and administrative expenses increased by \$1.7 million, or 30%, for the three months ended June 30, 2013 as compared to the same period in 2012. The increase was driven by higher costs to support our growing business. We incurred increased employee-related costs of \$1.1 million as a result of increased headcount and stock-based compensation awards between June 30, 2012 and June 30, 2013. In addition, we incurred increased software license

subscription fees of \$0.5 million. The absolute dollar increase of general and administrative expenses are expected to increase with the growth of our company.

General and administrative expenses increased by \$4.4 million, or 37%, for the six months ended June 30, 2013 as compared to the same period in 2012. The increase was driven by higher employee-related costs and to support our growing



business. We incurred increased employee-related costs of \$2.1 million as a result of increased headcount and stock-based compensation awards between June 30, 2012 and June 30, 2013. In addition, we incurred increased software license subscription fees of \$0.9 million, and increased travel and entertainment expenses of \$0.3 million. Amortization of certain acquired intangible assets

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in thousands)			
Amortization of certain acquired intangible assets	\$251	\$237	\$502	\$237

Amortization of acquired intangibles remained consistent for the three months ended June 30, 2013, as compared to the same period in 2012. Amortization of acquired intangibles increased by \$0.3 million, or 112% for the six months ended June 30, 2013, as compared to the same period in 2012 due to the amortization of intangible assets acquired through the April 2012 acquisition of Sonar Limited.

The following table presents our estimate of remaining amortization expense for each of the five succeeding fiscal years ending December 31 for finite-lived intangible assets that existed at June 30, 2013 (in thousands):

2013	\$1,134
2014	2,078
2015	1,840
2016	554
2017	145
Thereafter	7
Total	\$5,758

Estimated remaining amortization expense of \$0.4 million, \$1.2 million, \$1.2 million, \$0.4 million, and \$0.1 million will be recorded in cost of revenue for 2013, 2014, 2015, 2016, and 2017 and thereafter, respectively. The remaining estimated amortization expense will be recorded in amortization of certain acquired intangible assets within operating expenses.

#### Other Income (Expense)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in thousands)			
Interest expense	\$(505)	\$(94)	\$(584)	\$(237)
Other, net	(209)	(420)	(222)	(181)
Total	\$(714)	\$(514)	\$(806)	\$(418)

Interest expense for the three months ended June 30, 2013 increased by \$0.4 million as compared to the same period in 2012 due to accretion of debt discount and the amortization of debt issuance costs of \$0.3 million and interest expense of \$0.1 million for the convertible notes issued in June 2013. Refer to the section titled "Liquidity and Capital Resources" below for additional information on the convertible notes.

Interest expense for the six months ended June 30, 2013 increased by \$0.3 million as compared to the same period in 2012 due to accretion of debt discount and the amortization of debt issuance costs of \$0.3 million and interest expense of \$0.1 million for the convertible notes in June 2013.

Other, net is comprised of foreign exchange gains and losses. Foreign exchange gains and losses for the three and six months ended June 30, 2013 and 2012, respectively, were primarily related to fluctuations in the British Pound and Euro in relation to the U.S. Dollar. The foreign exchange gains and losses are mainly attributable to unrealized foreign exchange gains and losses on intercompany loans and other monetary accounts and realized gains and losses on transactions recorded in foreign currencies. During the three months ended June 30, 2013, we had unrealized foreign

exchange losses of \$0.3 million, offset by realized gains of \$0.1 million, as compared to unrealized losses of \$0.4 million partially offset by realized gains of

\$50,000 in the same period in 2012. During the six months ended June 30, 2013, we had unrealized losses of \$0.6 million, partially offset by realized gains of \$0.3 million, as compared to unrealized losses of \$0.2 million in the same period in 2012.

#### Income Tax Benefit

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
	(dollars in thousands)			
Income tax benefit	\$ 136	\$ 334	\$ 135	\$ 252

For the three and six months ended June 30, 2013, we recorded an income tax benefit related to the amortization of deferred tax liabilities assumed in connection with the Sonar acquisition partially offset by foreign income taxes.

We have incurred operating losses in the U.S. and U.K. in all annual periods to date and have recorded a full valuation allowance against our U.S. and U.K. net deferred tax assets and, therefore, have not recorded a provision for income taxes for any of the periods presented, other than provisions for certain foreign income taxes. Realization of any of our deferred tax assets depends upon future earnings, the timing and amount of which are uncertain.

#### Liquidity and Capital Resources

In June 2013, we issued \$253 million of 1.5% convertible notes due July 1, 2018 (the "Notes") and concurrently entered into convertible notes hedges and separate warrant transactions. The Notes will mature on July 1, 2018, unless earlier converted. Upon conversion of any Notes, we will deliver cash up to the principal amount, and we have the right to settle any amounts in excess of the principal in cash or shares. We received proceeds of \$246.0 million from the issuance of the convertible notes, net of associated fees, received \$23.2 million from the issuance of the warrants and paid \$49.5 million for the note hedges. The Notes are classified as a noncurrent liability on our condensed consolidated balance sheet as of June 30, 2013.

At June 30, 2013, our principal sources of liquidity were \$290.3 million of cash and cash equivalents and \$44.1 million of accounts receivable.

Our cash flows from operating activities have historically been significantly impacted by the contractual payment terms and patterns of client agreements, as well as our investments in sales and marketing and research and development to drive our business growth.

We intend to use our cash for general corporate purposes, including potential future acquisitions or other transactions. Depending on certain growth opportunities, we may choose to accelerate investments in sales and marketing, research and development, technology and services, which may require the use of proceeds for such additional expansion and expenditures. Based on our current level of operations and anticipated growth, we believe our future cash flows from operating activities and existing cash and cash equivalents, will provide adequate funds for our ongoing operations and general corporate purposes for at least the next twelve months. Our future capital requirements will depend on many factors, including our rate of revenue, billings growth and collections, the level of our sales and marketing efforts, the timing and extent of spending to support product development efforts and expansion into new territories, the timing of introductions of new services and enhancements to existing services, the timing of general and administrative expenses as we grow our administrative infrastructure, the continuing market acceptance of our solution. To the extent that existing cash and cash from operations are not sufficient to fund our future activities, we may need to raise additional funds or utilize our cash resources. Although we are not currently a party to any agreement or letter of intent with respect to potential investments in, or acquisitions of, complementary businesses, services or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity financing or utilize our cash resources.

The following table sets forth a summary of our cash flows for the periods indicated (in thousands):

	Six Months Ended June 30,	
	2013	2012
Net cash used in operating activities	\$(1,114	) \$(2,360
Net cash used in investing activities	(5,791	) (15,078
Net cash provided by (used in) financing activities	221,022	(884
Net Cash Used in Operating Activities		

Our cash flows from operating activities are significantly influenced by our growth, ability to maintain our contractual billing and collection terms, and our investments in headcount and infrastructure to support anticipated growth. Given the seasonality of our business, our cash flows from operations will vary from period to period.

Cash used in operating activities of \$1.1 million in the six months ended June 30, 2013 was a result of the continued growth of our business and our continued investments for further growth. In the six months ended June 30, 2013, \$13.3 million, or 71%, of our net loss of \$18.6 million consisted of non-cash items, including \$8.3 million of stock-based compensation and \$4.4 million of depreciation and amortization.

Cash used in operating activities in the six months ended June 30, 2013 also included a \$3.2 million increase in prepaid and other assets due to an increase in business activity associated with the growth of our business and the timing of payments to vendors, a \$1.8 million increase in deferred commissions due to increased sales during the period, and a \$1.4 million decrease in accrued liabilities primarily due to the timing of payments. Cash used in operating activities was partially offset by a \$4.2 million increase in deferred revenue due to increased billings during the six months ended June 31, 2013, an increase in accounts payable of \$3.9 million attributable to increased expenses associated with our growth, and a \$2.5 million decrease in accounts receivable due to the receipt of payments from our clients mainly the result of higher billings in the fourth quarter of 2012 due to the seasonality of our business.

Cash used in operating activities of \$2.4 million in the six months ended June 30, 2012 was a result of our continued significant investments in headcount, increased expenses incurred as a result of operating as a public company, including costs associated with public company reporting and corporate governance requirements, and other expenses incurred to grow our business. In the six months ended June 30, 2012, \$7.9 million, or 48%, of our net loss of \$16.3 million consisted of non-cash items, including \$5.0 million of stock-based compensation, and \$3.0 million of depreciation and amortization.

Cash used in operating activities in the six months ended June 30, 2012 also included a \$0.6 million increase in prepaid and other assets due to an increase in business activity associated with the growth of our business and the timing of payments to vendors, and a \$0.4 million decrease in accrued liabilities primarily due to the timing of payments. Cash used in operating activities was partially offset by a \$4.3 million increase in deferred revenue due to increased billings during the six months ended June 30, 2012, a \$2.0 million decrease in accounts receivable attributable to the receipt of payments from our clients mainly the result of higher billings in the fourth quarter of 2011 due to the seasonality of our business, and an increase in accounts payable of \$0.6 million attributable to increased expenses associated with our growth and an increase in other liabilities of \$0.4 million.

#### Net Cash Used in Investing Activities

Our primary investing activities have consisted of capital expenditures to develop our capitalized software as well as to purchase computer equipment, leasehold improvements, and furniture and fixtures in support of expanding our infrastructure and workforce. As our business grows, we expect our capital expenditures and our investment activity to continue to increase.

We used \$5.8 million of cash in investing activities in the six months ended June 30, 2013, primarily due to \$3.4 million of investments in our capitalized software and \$2.4 million in purchases of additional equipment during the period.

We used \$15.1 million of cash in investing activities in the six months ended June 30, 2012, primarily due to our acquisition of Sonar Limited of \$12.4 million, \$2.5 million of investments in our capitalized software, and \$0.2 million in purchases of additional equipment during the period.



#### Net Cash Provided by (Used in) Financing Activities

Cash provided by financing activities of \$221.0 million in the six months ended June 30, 2013 was primarily due to proceeds from our convertible notes of \$246.0 million and proceeds from the issuance of warrants of \$23.2 million, and proceeds from stock option exercises of \$4.1 million. These proceeds were partially offset by our payment for the convertible note hedges of \$49.5 million and repayment of our credit facility of \$3.8 million.

Cash used in financing activities of \$0.9 million in the six months ended June 30, 2012 was primarily due to debt repayment of \$1.0 million, and payments of \$0.9 million on our capital lease and financing obligations, partially offset by \$1.0 million in proceeds from stock option exercises and common stock warrant exercises.

#### Contractual Obligations

There have been no significant changes in contractual obligations from those disclosed in our Annual Report on Form 10-K filed with the SEC on March 1, 2013 except for the following: during the six months ended June 30, 2013, we amended our office lease with Water Garden Realty Holding LLC increasing our obligation by approximately \$0.1 million for 2013, \$0.6 million for 2014, \$0.7 million for 2015, \$0.7 million for 2016, \$0.7 million for 2017, and \$0.5 million for 2018. We also entered into various other operating lease agreements with obligations of approximately \$0.2 million for 2013, \$0.2 million for 2014, and \$0.2 million for 2015 and thereafter. Additionally in June 2013, we issued senior convertible notes (the "Notes") raising gross proceeds of \$253.0 million. The Notes are governed by an Indenture, dated June 17, 2013, between us and U.S. Bank National Association, as trustee. The Notes will mature on July 1, 2018, unless earlier repurchased or converted, and bear interest at a rate of 1.50% per year payable semi-annually in arrears on January 1 and July 1 of each year, commencing January 1, 2014.

#### Off-Balance Sheet Arrangements

As part of our ongoing business, we do not have any relationships with other entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, that have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. We are therefore not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in those types of relationships.

#### ITEM 3. Quantitative and Qualitative Disclosures About Market Risks

We have operations both within the United States and internationally, and we are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate, foreign exchange and inflation risks, as well as risks relating to changes in the general economic conditions in the countries where we conduct business. To reduce certain of these risks, we monitor the financial condition of our large clients and limit credit exposure by collecting in advance and setting credit limits as we deem appropriate. In addition, our investment strategy has been to invest in financial instruments that are highly liquid and readily convertible into cash and that mature within three months from the date of purchase. To date, we have not used derivative instruments to mitigate the impact of our market risk exposures. We have also not used, nor do we intend to use, derivatives for trading or speculative purposes.

##### Interest Rate Risk

At June 30, 2013, we had cash and cash equivalents of \$290.3 million, which primarily consisted of money market funds backed by United States Treasury Bills. The carrying amount of our cash equivalents reasonably approximates fair value due to the short maturities of these instruments.

The primary objectives of our investment activities are the preservation of capital, the fulfillment of liquidity needs and the fiduciary control of cash and investments. We do not enter into investments for trading or speculative purposes. Our investments are exposed to market risk due to fluctuations in interest rates, which may affect our interest income and the fair market value of our investments. Due to the short-term nature of our investment portfolio, however, we do not believe an immediate 10% increase or decrease in interest rates would have a material effect on the fair market value of our portfolio. We therefore do not expect our operating results or cash flows to be materially affected by a sudden change in market interest rates.

We do not believe our cash equivalents have significant risk of default or illiquidity. While we believe our cash equivalents do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash

equivalents at one or more financial institutions that are in excess of federally insured limits. We cannot be assured that we will not experience losses on these deposits.

#### Foreign Currency Risk

We have foreign currency risks related to our revenue and operating expenses denominated in currencies other than the U.S. Dollar. Our historical revenue has primarily been denominated in U.S. Dollars, and a significant portion of our current revenue continues to be denominated in U.S. Dollars. However, we expect an increasing portion of our future revenue to be denominated in currencies other than the U.S. Dollar, primarily the Euro and British Pound. To a lesser extent, we also have revenue denominated in Australian Dollars, Canadian Dollars, Indian Rupees, Japanese Yen, New Zealand Dollars, Singapore Dollars, and South African Rand. Our operating expenses are generally denominated in the currencies of the countries in which our operations are located, primarily the United States and, to a much lesser extent, the United Kingdom, other European Union countries, Australia, Canada, Hong Kong, India, Israel, Italy and New Zealand. Increases and decreases in our foreign-denominated revenue from movements in foreign exchange rates are often partially offset by the corresponding decreases or increases in our foreign-denominated operating expenses. Our other income (expense) is also impacted by the remeasurement of U.S. Dollar denominated intercompany loans by our overseas subsidiaries.

As our international operations grow, our risks associated with fluctuation in currency rates will become greater, and we will continue to reassess our approach to managing this risk. In addition, currency fluctuations or a weakening U.S. Dollar can increase the costs of our international expansion. To date, we have not entered into any foreign currency hedging contracts although we may do so in the future. The effect of an immediate 10% adverse change in foreign exchange rates on foreign-denominated accounts at June 30, 2013, including our intercompany loans with our subsidiaries, would result in a foreign currency loss of approximately \$3.2 million.

#### Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. Nonetheless, if our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

#### Counterparty Risk

Our financial statements are subject to counterparty credit risk, which we consider as part of the overall fair value measurement. We attempt to mitigate this risk through credit monitoring procedures.

### ITEM 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), refers to controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to a company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2013, the end of the period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of such date.

#### Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings



From time to time, we are subject to various legal proceedings that arise in the normal course of our business activities. In addition, from time to time, third parties may assert intellectual property infringement claims against us in the form of letters and other forms of communication. As of the date of this Quarterly Report on Form 10-Q, we are not a party to any litigation

the outcome of which, if determined adversely to us, would individually or in the aggregate be reasonably expected to have a material adverse effect on our results of operations, prospects, cash flows, financial position or brand.

#### ITEM 1A. Risk Factors

The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. Please see page 17 of this Quarterly Report on Form 10-Q for a discussion of the forward-looking statements that are qualified by these risk factors. If any of the events or circumstances described in the following risk factors actually occurs, our business, operating results and financial condition could be materially adversely affected.

##### Risks Related to Our Business and Industry

We have a history of losses, and we cannot be certain that we will achieve or sustain profitability.

We have incurred losses since our inception. We experienced net losses of \$8.7 million, \$18.6 million, \$31.4 million, \$63.9 million, and \$48.4 million for the three and six months ended June 30, 2013, and years ended December 31, 2012, 2011 and 2010, respectively. At June 30, 2013, our accumulated deficit was \$214.7 million and total stockholders' equity was \$52.9 million. We expect to continue to incur operating losses as a result of expenses associated with the continued development and expansion of our business. Our expenses include among others, sales and marketing, research and development, consulting and support services and other costs relating to the development, marketing and sale and service of our solutions that may not generate revenue until later periods, if at all. Any failure to increase revenue or manage our cost structure as we implement initiatives to grow our business could prevent us from achieving or sustaining profitability. In addition, our ability to achieve profitability is subject to a number of the risks and uncertainties discussed below, many of which are beyond our control. We cannot be certain that we will be able to achieve or sustain profitability on a quarterly or annual basis.

Unfavorable conditions in our industry or the global economy, or reductions in information technology spending, could limit our ability to grow our business and negatively affect our operating results.

Our operating results may vary based on the impact of changes in our industry or the global economy on us or our clients. The revenue growth and potential profitability of our business depends on demand for enterprise application software and services generally and for talent management solutions in particular. We sell our core solution primarily to large mid-sized and small business organizations whose businesses fluctuate based on general economic and business conditions. In addition, a portion of our revenue is attributable to the number of users of our solutions at each of our clients, which in turn is influenced by the employment and hiring patterns of our clients and potential clients. To the extent that weak economic conditions cause our clients and potential clients to freeze or reduce their headcount, demand for our solutions may be negatively affected. Historically, economic downturns have resulted in overall reductions in spending on information technology or talent management solutions as well as pressure for extended billing terms, as occurred during the recent recession. If economic conditions deteriorate or do not materially improve, our clients and potential clients may elect to decrease their information technology and talent management budgets by deferring or reconsidering product purchases, which would limit our ability to grow our business and negatively affect our operating results.

Our financial results may fluctuate due to our long, variable and, therefore, unpredictable sales cycle and our focus on large and mid-market organizations.

We plan our expenses based on certain assumptions about the length and variability of our sales cycle. If our sales cycle becomes longer or more variable, our results may be adversely affected. Our sales cycle generally varies in duration between two to nine months and, in some cases, much longer depending on the size of the potential client. Factors that may influence the length and variability of our sales cycle include among others:

- the need to educate potential clients about the uses and benefits of our solutions;
- the relatively long duration of the commitment clients make in their agreements with us;
- the discretionary nature of potential clients' purchasing and budget cycles and decisions;
- the competitive nature of potential clients' evaluation and purchasing processes;

evolving functionality demands of potential clients;  
fluctuations in the talent management needs of potential clients;  
announcements or planned introductions of new products by us or our competitors; and  
lengthy purchasing approval processes of potential clients.

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The fluctuations that result from the length and variability of our sales cycle may be magnified by our focus on sales to large and mid-sized organizations. If we are unable to close an expected significant transaction with one or more of these companies in a particular period, or if an expected transaction is delayed until a subsequent period, our operating results, and in particular our bookings, for that period, and for any future periods in which revenue from such transaction would otherwise have been recognized, may be adversely affected.

Our financial results may fluctuate due to other factors, including invoicing terms, some of which may be beyond our control.

There are a number of other factors that may cause our financial results to fluctuate from period to period, including among others:

- changes in billing cycles and the size of advance payments relative to overall contract value in client agreements;
- the extent to which new clients are attracted to our solutions to satisfy their talent management needs;
- the timing and rate at which we sign agreements with new clients;
- our access to service providers when we outsource client service projects and our ability to manage the quality and completion of the related client implementations;
- the timing and duration of our client implementations, which is often outside of our direct control, and our ability to provide resources for client implementations and consulting projects;
- the extent to which we retain existing clients and satisfy their requirements;
- the extent to which existing clients renew their subscriptions to our solutions and the timing of those renewals;
- the extent to which existing clients purchase or discontinue the use of additional solutions and add or decrease the number of users;
- the extent to which our clients request enhancements to underlying features and functionality of our solutions and the timing for us to deliver the enhancements to our clients;
- the addition or loss of large clients, including through acquisitions or consolidations;
- the number and size of new clients, as well as the number and size of renewal clients in a particular period;
- the mix of clients between small, mid-sized and large organizations;
- changes in our pricing policies or those of our competitors;
- seasonal factors affecting demand for our solutions or potential clients' purchasing decisions;
- the financial condition and creditworthiness of our clients;
- the amount and timing of operating expenses, including those related to the maintenance and expansion of our business, operations and infrastructure;
- the timing and success of new product and service introductions by us;
- the timing of expenses related to the development of new products and technologies, including enhancements to our solutions;
- the timing and success of current and new competitive products and services by our competitors;
- other changes in the competitive dynamics of our industry, including consolidation among competitors, clients or strategic partners;
- our ability to manage our existing business and future growth, including in terms of additional clients, incremental users and new geographic regions;
- expenses related to our data centers and the expansion of such data centers;
- the effects of, and expenses associated with, acquisitions of third-party technologies or businesses and any potential future charges for impairment of goodwill resulting from those acquisitions;
- general economic, industry and market conditions; and
- various factors related to disruptions in our SaaS hosting network infrastructure, defects in our solutions, privacy and data security, and exchange rate fluctuations, each of which is described elsewhere in these risk factors.

In light of the foregoing factors, we believe that our financial results, including our revenue and deferred revenue levels, may vary significantly from period-to-period. As a result, period-to-period comparisons of our operating results may not be meaningful and should not be relied on as an indication of future performance.



The forecasts of market growth may prove to be inaccurate, and even if the markets in which we compete achieve the forecasted growth, we cannot assure you our business will grow at similar rates, or at all.

Growth forecasts are subject to significant uncertainty and are based on assumptions and estimates which may not prove to be accurate. Forecasts relating to the expected growth in the SaaS market or talent management market may prove to be inaccurate. Even if these markets experience the forecasted growth, we may not grow our business at similar rates, or at all. Our growth is subject to many factors, including our success in implementing our business strategy, which is subject to many risks and uncertainties.

Even if demand for talent management products and services increases generally, there is no guarantee that demand for SaaS solutions like ours will increase to a corresponding degree.

The widespread adoption of our solutions depends not only on strong demand for talent management products and services generally, but also for products and services delivered via a SaaS business model in particular. There are still a significant number of organizations that have adopted no talent management functions at all, and it is unclear whether such organizations ever will adopt such functions and, if they do, whether they will desire SaaS talent management solutions like ours. As a result, we cannot assure you that our SaaS talent management solutions will achieve and sustain the high level of market acceptance that is critical for the success of our business.

Our business depends substantially on clients renewing their agreements and purchasing additional solutions from us or adding additional users. Any decline in our client renewals or purchases of additional clouds or additional users would harm our future operating results.

In order for us to improve our operating results, it is important that our clients renew their agreements with us when the initial contract term expires and also purchase additional clouds or add additional users. Our clients have no obligation to renew their subscriptions after the initial subscription period, and we cannot assure you that clients will renew subscriptions at the same or higher level of service, if at all. In the past, some of our clients have elected not to renew their agreements with us. Moreover, certain of our clients have the right to cancel their agreements for convenience, subject to certain notice requirements and, in some cases, early termination fees. Our clients' renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our solutions, pricing, the prices of competing products or services, mergers and acquisitions affecting our client base, reduced hiring by our clients or reductions in our clients' spending levels. If our clients do not renew their subscriptions, renew on less favorable terms, fail to purchase additional clouds, or fail to add new users, our revenue may decline, and our operating results may be harmed.

The market in which we participate is intensely competitive, and if we do not compete effectively, our operating results could be harmed.

The market for talent management software is highly competitive, rapidly evolving and fragmented. Many of our competitors and potential competitors are larger and have greater brand name recognition, much longer operating histories, larger marketing budgets and significantly greater resources than we do, and, with the introduction of new technologies and market entrants, we expect competition to intensify in the future. If we fail to compete effectively, our business will be harmed. Some of our principal competitors offer their products or services at a lower price, which has resulted in pricing pressures. Similarly, some competitors offer different billing terms, which has resulted in pressures on our billing terms. If we are unable to maintain our pricing levels and billing terms, our operating results could be negatively impacted. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses or the failure of our solution to achieve or maintain more widespread market acceptance, any of which could harm our business.

We face competition from paper-based processes and desktop software tools. We also face competition from custom-built software that is designed to support the needs of a single organization, as well as from third-party talent and human resource application providers. These software vendors include, without limitation, Halogen Software, Inc., Kenexa, Inc., which was acquired by International Business Machines Corporation in August 2012, Lumesse AS, Peoplefluent, Inc., Saba Software, Inc., SilkRoad Technology, Inc., SuccessFactors, Inc., which was acquired by SAP America, Inc. in February 2012, SumTotal Systems, Inc., and Taleo Corporation, which was acquired by Oracle Corporation in April 2012. In addition, some of the parties with which we maintain business alliances offer or may offer products or services that compete with our products or services.

Many of our competitors are able to devote greater resources to the development, promotion and sale of their products and services. In addition, many of our competitors have established marketing relationships, access to larger client bases and major distribution agreements with consultants, system integrators and distributors. Moreover, many software vendors could bundle human resource products or offer such products at a lower price as part of a larger product sale. In addition, some competitors may offer software that addresses one, or a limited number, of talent management functions at a lower price point or with greater depth than our solutions. As a result, our competitors may be able to respond more quickly and effectively than

we can to new or changing opportunities, technologies, standards or client requirements. Further, some potential clients, particularly large enterprises, may elect to develop their own internal solutions. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

Mergers of or other strategic transactions by our competitors could weaken our competitive position or reduce our revenue.

If one or more of our competitors were to merge, acquire or partner with another of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively. For example, in February 2012, SAP America, Inc. acquired SuccessFactors, Inc., one of our competitors; in April 2012, Oracle Corporation acquired Taleo Corporation, another one of our competitors; and in August 2012 International Business Machines Corporation acquired Kenexa, Inc., also one of our competitors. Our competitors may also establish or strengthen cooperative relationships with our current or future strategic distributors, systems integrators, HR outsourcers, payroll services companies, third-party consulting firms or other parties with whom we have relationships, thereby limiting our ability to promote our solutions and limiting the number of consultants available to implement our solutions. Disruptions in our business caused by these events could reduce our revenue.

Our business and operations are experiencing rapid growth and organizational change. If we fail to effectively manage such growth and change in a manner that preserves the key aspects of our corporate culture, our business and operating results could be harmed.

We have experienced, and may continue to experience, rapid growth and organizational change, which has placed, and may continue to place, significant demands on our management, operational and financial resources. For example, our headcount has grown from 750 employees on December 31, 2012 to 881 employees on June 30, 2013. In addition, we have established offices in Australia, France, Germany, Hong Kong, India, Israel, Italy, New Zealand, Spain and the United Kingdom. We may continue to expand our international operations into other countries in the future, either organically or through acquisitions. We have also experienced significant growth in the number of users, transactions and data that our SaaS hosting infrastructure supports. Finally, our organizational structure is becoming more complex as we improve our operational, financial and management controls as well as our reporting systems and procedures. We will require significant capital expenditures and the allocation of valuable management resources to grow and change in these areas without undermining our corporate culture of rapid innovation, teamwork and attention to client success that has been central to our growth so far. If we fail to manage our anticipated growth and change in a manner that preserves the key aspects of our corporate culture, the quality of our solution may suffer, which could negatively affect our brand and reputation and harm our ability to retain and attract clients.

For a detailed discussion of the risks related to our ability to expand our business internationally, manage growth in our SaaS hosting network infrastructure, and expand parts of our organization to implement improved operational, financial and management controls and reporting systems, see the following risk factors “—As a public company, we are obligated to develop and maintain proper and effective internal control over financial reporting. If our internal control over financial reporting is ineffective, our financial reporting may not be accurate, complete and timely, and our auditors may be unable to attest to its effectiveness when required, thus adversely affecting investor confidence in our company.” And “We currently have a limited number of international offices and are expanding our international operations. Additionally, we do not have substantial experience in all international markets and may not achieve the results that we expect.”

We may acquire other companies or technologies, which could divert our management’s attention, result in additional dilution to our stockholders or otherwise disrupt our operations and harm our operating results.

In April 2012, we acquired Sonar Limited, a SaaS talent management solution provider serving small businesses. In the future, we may seek to acquire or invest in other businesses, products or technologies that we believe could complement or expand our existing solutions, enhance our technical capabilities or otherwise offer growth opportunities. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are ultimately consummated.

Other than our acquisition of Sonar Limited, we do not have any experience in acquiring other businesses. We may not be able to successfully integrate the personnel, operations and technologies of any other businesses that we may



acquire in the future or effectively manage the combined business following the acquisition. We may also not achieve the anticipated benefits from other acquired businesses due to a number of factors, including:

- unanticipated costs or liabilities associated with the acquisition;
- incurrence of acquisition-related costs;
- diversion of management's attention from other business concerns;
- harm to our existing relationships with distributors and clients as a result of the acquisition;

- the potential loss of key employees;
- the use of resources that are needed in other parts of our business; and
- the use of substantial portions of our available cash to consummate the acquisition.

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

Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. For example, in our recent acquisition of Sonar Limited, we issued an aggregate of 46,694 shares of our common stock. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial condition may suffer.

As a public company, we are obligated to develop and maintain proper and effective internal control over financial reporting. If our internal control over financial reporting is ineffective, our financial reporting may not be accurate, complete and timely, and our auditors may be unable to attest to its effectiveness when required, thus adversely affecting investor confidence in our company.

We are required, pursuant to Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. Our auditors also need to audit the effectiveness of our internal control over financial reporting. These assessments will need to include disclosure of any material weaknesses in our internal control over financial reporting.

We have incurred significant costs assessing our system of internal control over financial reporting and processing documentation necessary to perform the evaluation needed to comply with Section 404. We may discover, and may not be able to remediate, future significant deficiencies or material weaknesses, or we may be unable to complete our evaluation, testing or any required remediation in a timely fashion. Failure of our internal control over financial reporting to be effective could cause our financial reporting to be inaccurate, incomplete or delayed. Moreover, even if no inaccuracy, incompleteness or delay of reporting results, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert, and our auditors will be unable to affirm, that our internal control is effective, in which case investors may lose confidence in the accuracy and completeness of our financial reports, which could have a material adverse effect on the price of our common stock.

Our systems collect, access, use and store personal and other client proprietary information. As a result, we are subject to security risks and are required to invest significant resources to prevent or correct problems caused by security breaches. If a security breach occurs, our reputation could be harmed, our business may suffer, and we could incur significant liability.

Our talent management solutions involve the storage and transmission of clients' proprietary and confidential information over the Internet (including public networks), and security breaches, unauthorized access, unauthorized usage, virus or similar breach or disruption could result in loss of this information, damage to our reputation, early termination of our contracts, litigation, regulatory investigations or other liabilities. In addition, errors in the storage or transmission of such information could compromise the security of that information. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise and, as a result, someone obtains unauthorized access to client data, our reputation will be damaged, our business may suffer and we could incur significant liability. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments could result in compromises or breaches of our security systems and the data stored in these systems. Because there is a time lag associated with developing adequate protections against such new developments and techniques, unauthorized access or sabotage of our systems and the information processed in connection with our business may result. If an actual or perceived security breach occurs, the market perception of our security measures could be harmed and we could lose sales and clients. Any violations of privacy or information security could result in the loss of business, litigation and regulatory investigations and penalties that could damage our reputation and adversely impact our results of operations and financial condition, including our ability to make required reporting and disclosures as a public company. Moreover, if a high profile security breach occurs with respect to another SaaS

provider, our clients and potential clients may lose trust in the security of the SaaS business model generally, which could adversely impact our ability to retain existing clients or attract new ones.

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Any significant disruption in our SaaS hosting network infrastructure could harm our reputation, require us to provide credits or refunds, result in early termination of a client agreement or a loss of clients, and adversely affect our business.

Our SaaS hosting network infrastructure is a critical part of our business operations. Our clients access our talent management solutions through a standard web browser. Our clients depend on us for fast and reliable access to our solutions. Our software is proprietary, and we rely on the expertise of members of our engineering and software development teams for the continued performance of our solutions. We have experienced, and may in the future experience, disruptions in our computing and communications infrastructure. Factors that may cause such disruptions that may harm our reputation include:

- human error;
- security breaches;
- telecommunications outages from third-party providers;
- computer viruses;
- acts of terrorism, sabotage or other intentional acts of vandalism, including cyber attacks;
- unforeseen interruption or damages experienced in moving hardware to a new location;
- fire, earthquake, flood and other natural disasters; and
- power loss.

Although we generally back up our client databases hourly, store our data in more than one geographically distinct location at least weekly and perform real-time mirroring of data to disaster recovery locations, we do not currently offer immediate access to disaster recovery locations in the event of a disaster or major outage. Thus, in the event of any of the factors described above, or certain other failures of our computing infrastructure, clients may not be able to access their data for 24 hours or more. There is a remote chance that client data from recent transactions may be permanently lost or otherwise compromised. Moreover, some of our agreements include performance guarantees and service level standards that obligate us to provide credits, or refunds or termination rights in the event of a significant disruption in our SaaS hosting network infrastructure or other technical problems that relate to the functionality or design of our solutions.

We rely on third-party computer hardware and software that may be difficult to replace or could cause errors or failures of our service.

In addition to the software we develop, we rely on computer hardware, purchased or leased, and software licensed from third parties in order to deliver our solutions. This hardware and software may not continue to be available on commercially reasonable terms, if at all. Any loss of the right to use any of this hardware or software could result in delays in our ability to provide our solutions until equivalent technology is either developed by us or, if available, identified, obtained and integrated. In addition, errors or defects in third-party hardware or software used in our solutions could result in errors or a failure of our solutions, which could harm our business. Moreover, we utilize self-managed, co-location facilities. If our co-location facilities do not scale and support our continued growth on a more cost-effective basis than a fully managed third-party environment, our business may be negatively impacted. Defects in our solutions could affect our reputation, result in significant costs to us, and impair our ability to sell our solutions and related services.

Defects in our solutions could adversely affect our reputation, result in significant costs to us, and impair our ability to sell our solutions in the future. The costs incurred in correcting any solution defects may be substantial and could adversely affect our operating results. Although we continually test our solutions for defects and work with clients through our client support organization to identify and correct errors, defects in our solutions are likely to occur in the future. Any defects that cause interruptions to the availability of our solutions could result in:

- lost or delayed market acceptance and sales of our solutions;
- early termination of client agreements or loss of clients;
- credits or refunds to clients;
- product liability suits against us;
- diversion of development resources;

• injury to our reputation; and  
• increased maintenance and warranty costs.

While our client agreements typically contain limitations and disclaimers that purport to limit our liability for damages related to defects in our solutions, such limitations and disclaimers may not be enforced by a court or other tribunal or otherwise effectively protect us from such claims.

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If we fail to manage our SaaS hosting network infrastructure capacity, our existing clients may experience service outages and our new clients may experience delays in the deployment of our talent management solutions. We have experienced significant growth in the number of users, transactions and data that our hosting infrastructure supports. We seek to maintain sufficient excess capacity in our SaaS hosting network infrastructure to meet the needs of all of our clients. We also seek to maintain excess capacity to facilitate the rapid provision of new client deployments and the expansion of existing client deployments. However, the provision of new hosting infrastructure requires significant lead time. If we do not accurately predict our infrastructure capacity requirements, our existing clients may experience service outages that may subject us to financial penalties, financial liabilities and client losses. If our hosting infrastructure capacity fails to keep pace with increased sales, clients may experience delays as we seek to obtain additional capacity, which could harm our reputation and adversely affect our revenue growth.

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

We anticipate that we will continue to depend on various third-party relationships in order to grow our business. In addition to growing our indirect sales channels, we intend to pursue additional relationships with other third parties, such as technology and content providers and implementation consultants. Identifying, negotiating and documenting relationships with third parties require significant time and resources, as does integrating third-party content and technology. Our agreements with distributors and providers of technology, content and consulting services are typically non-exclusive, do not prohibit them from working with our competitors or from offering competing services. Our competitors may be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our solutions. In addition, these distributors and providers may not perform as expected under our agreements, and we have had, and may in the future have, disagreements or disputes with such distributors and providers, which could negatively affect our brand and reputation. A global economic slowdown could also adversely affect the businesses of our distributors, and it is possible that they may not be able to devote the resources we expect to our relationships with such distributors.

If we are unsuccessful in establishing or maintaining our relationships with these third parties, our ability to compete in the marketplace or to grow our revenue could be impaired and our operating results could suffer. Even if we are successful, we cannot assure you that these relationships will result in improved operating results.

Failure to effectively expand our direct sales teams and develop and expand our indirect sales channel will impede our growth.

We will need to continue to expand our sales and marketing infrastructure in order to grow our client base and our business. We plan to significantly expand our direct sales teams and engage additional third-party distributors, both domestically and internationally. Identifying, recruiting and training these people and entities will require significant time, expense and attention. Our business will be seriously harmed and our financial resources will be wasted if our efforts to expand our direct and indirect sales channels do not generate a corresponding increase in revenue. In particular, if we are unable to hire, develop and retain talented sales personnel or if our new direct sales personnel are unable to achieve expected productivity levels in a reasonable period of time, we may not be able to significantly increase our revenue and grow our business.

If we fail to retain key employees and recruit qualified technical and sales personnel, our business could be harmed. We believe that our success depends on the continued employment of our senior management and other key employees, such as our chief executive officer. In addition, because our future success is dependent on our ability to continue to enhance and introduce new software and services, we are heavily dependent on our ability to attract and retain qualified engineers with the requisite education, background and industry experience. As we expand our business, our continued success will also depend, in part, on our ability to attract and retain qualified sales, marketing and operational personnel capable of supporting a larger and more diverse client base. The loss of the services of a significant number of our engineers or sales people could be disruptive to our development efforts or business relationships. In addition, if any of our key employees joins a competitor or decides to otherwise compete with us, we may experience a material disruption of our operations and development plans, which may cause us to lose clients or increase operating expenses as the attention of our remaining senior managers is diverted to recruit replacements for the departed key employees.

In cases where we are asked by clients to deploy our solutions on their behalf, failure to effectively manage such client deployments by us or our third-party service providers could adversely impact our business.

Clients have the option of implementing our solutions themselves or relying on us to do so on their behalf. In cases where we are asked to deploy a solution for a client, we need to have a substantial understanding of such client's business so that we can configure the solution in a manner that complements its existing business processes and integrates the solution into its existing systems. It may be difficult for us to manage the timeliness of these deployments and the allocation of personnel and

resources by us or our clients. In certain situations, we also work with third-party service providers in the deployment of our solutions, and we may experience difficulties managing such third parties. Failure to successfully manage client deployments by us or our third-party service providers could harm our reputation and cause us to lose existing clients, face potential client disputes or limit the rate at which new clients purchase our solutions.

Because we recognize revenue from client subscriptions over the term of the agreement, a significant downturn in our business may not be immediately reflected in our operating results.

Generally, we recognize revenue from subscription agreements monthly over the terms of these agreements, which is typically three years for our core solution. As a result, a significant portion of the revenue we report in each quarter is generated from client agreements entered into during previous periods. Consequently, a decline in new or renewed subscriptions in any one quarter may not impact our revenue and financial performance in that quarter, but will negatively affect our revenue and financial performance in future quarters. If a number of contracts expire and are not renewed in the same quarter, our revenue will decline significantly in that quarter and subsequent quarters. In addition, we may be unable to adjust our fixed costs in response to reduced revenue. Accordingly, the effect of significant declines in sales and market acceptance of our solutions may not be reflected in our short-term results of operations.

Because we generally recognize subscription revenue from our clients over the terms of their agreements but incur most costs associated with generating such agreements upfront, rapid growth in our client base may put downward pressure on our operating income in the short term.

The expenses associated with generating client agreements are generally incurred up front but the resulting subscription revenue is generally recognized over the life of the agreements; therefore, increased growth in the number of our clients will result in our recognition of more costs than revenue during the early periods covered by such agreements, even in cases where the agreements are expected to be profitable for us over their full terms.

Certain of our operating results and financial metrics are difficult to predict as a result of seasonality.

We have historically experienced seasonality in terms of when we enter into client agreements for our solutions. We sign a significantly higher percentage of agreements with new clients, and renewal agreements with existing clients, in the fourth quarter of each year and a significant portion of these agreements are signed during the last month, and with respect to each quarter, often the last two weeks, of the quarter. This seasonality is reflected to a much lesser extent, and sometimes is not immediately apparent, in our revenue, due to the fact that we generally recognize subscription revenue over the term of the client agreement, which is generally three years. We expect this seasonality to continue, in the future, which may cause fluctuations in certain of our operating results and financial metrics, and thus difficulties in predictability.

Integrated, comprehensive SaaS solutions such as ours represent a relatively recent approach to addressing organizations' talent management challenges, and we may be forced to change the prices we charge for our solutions, or the pricing model upon which they are based, as the market for these types of solutions evolves.

Providing organizations with applications to address their talent management challenges through integrated, comprehensive SaaS solutions is a developing market. The market for these solutions is therefore still evolving, and competitive dynamics may cause pricing levels, as well as pricing models generally, to change, as the market matures and as existing and new market participants introduce new types of solutions and different approaches to enable organizations to address their talent management needs. As a result, we may be forced to reduce the prices we charge for our solutions or the pricing model on which they are based, and may be unable to renew existing client agreements or enter into new client agreements at the same prices and upon the same terms that we have historically, which could have a material adverse effect on our revenue, gross margin and other operating results.

Existing or future laws and regulations relating to privacy or data security could increase the cost of our solutions and subject us or our clients to litigation, regulatory investigations and other potential liabilities.

Our talent management solutions enable our clients to collect, manage and store a wide range of data related to every phase of the employee performance and management cycle. The United States and various state governments have adopted or proposed limitations on the collection, distribution and use of personal information. Several foreign jurisdictions, including the European Union and the United Kingdom, China, Korea, Japan, Singapore, Australia and India, have adopted legislation (including directives or regulations) that increase or change the requirements



governing data collection and storage in these jurisdictions. If our privacy or data security measures fail to comply with current or future laws and regulations, we may be subject to litigation, regulatory investigations or other liabilities. Moreover, if future laws and regulations limit our clients' ability to use and share employee data or our ability to store, process and share data with our clients over the Internet, demand

for our solutions could decrease, our costs could increase, and our results of operations and financial condition could be harmed.

Evolving regulation of the Internet or changes in the infrastructure underlying the Internet may adversely affect our financial condition by increasing our expenditures and causing client dissatisfaction.

As Internet commerce continues to evolve, regulation by federal, state or foreign agencies may increase. We are particularly sensitive to these risks because the Internet is a critical component of our business model. In addition, taxation of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet may also be imposed. Legislation has been proposed that may impact the way that Internet service providers treat Internet traffic. The outcome of such proposals is uncertain but certain outcomes may negatively impact our business or increase our operating costs. Any regulation imposing greater fees for Internet use or restricting information exchanged over the Internet could result in a decline in the use of the Internet and the viability of Internet-based services, which could harm our business.

In addition, the rapid and continual growth of traffic on the Internet has resulted at times in slow connection and download speeds among Internet users. Our business expansion may be harmed if the Internet infrastructure cannot handle our clients' demands or if hosting capacity becomes insufficient. If our clients become frustrated with the speed at which they can utilize our solutions over the Internet, our clients may discontinue the use of our talent management solutions and choose not to renew their contracts with us.

We currently have a limited number of international offices and are expanding our international operations.

Additionally, we do not have substantial experience in all international markets and may not achieve the results that we expect.

We currently have international offices in Australia, France, Germany, Hong Kong, India, Israel, Italy, New Zealand, Spain and the United Kingdom, and we may expand our international operations into other countries in the future.

International operations involve a variety of risks, including:

- unexpected changes in regulatory requirements, taxes, trade laws, tariffs, export quotas, custom duties or other trade restrictions;
- differing labor regulations;
- regulations relating to data security and the unauthorized use of, or access to, commercial and personal information;
- potential penalties or other adverse consequences for violations of anti-corruption, anti-bribery and other similar laws and regulations, including the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act.
- greater difficulty in supporting and localizing our products;
- changes in a specific country's or region's political or economic conditions;
- challenges inherent in efficiently managing an increased number of employees over large geographic distances, including the need to implement appropriate systems, controls, policies, benefits and compliance programs;
- limited or unfavorable intellectual property protection; and
- restrictions on repatriation of earnings.

We have less significant experience in marketing, selling and supporting our products and services abroad. Our less significant experience in operating our business internationally increases the risk that any potential future expansion efforts that we may undertake will not be successful. If we invest substantial time and resources to expand our international operations and are unable to do so successfully and in a timely manner, our business and operating results will suffer.

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

We believe that developing and maintaining awareness of the Cornerstone OnDemand brand in a cost-effective manner is critical to achieving widespread acceptance of our existing and future solutions and is an important element in attracting new clients. Furthermore, we believe that the importance of brand recognition will increase as competition in our market increases. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful services at competitive prices. In the past, our efforts to build our brand have involved significant expenses. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incurred in building our brand. In addition, the Cornerstone OnDemand Foundation shares our company name and any negative perceptions of any kind

about the Foundation could adversely affect our brand and reputation. If we fail to successfully promote and maintain our brand, or incur substantial expenses in an unsuccessful attempt to promote and

maintain our brand, we may fail to attract enough new clients or retain our existing clients to the extent necessary to realize a sufficient return on our brand-building efforts, and our business could suffer.

We face risks associated with our sales to governmental entities.

Sales to governmental entities currently account for a small portion of our revenue, but we may increase sales to such entities in the future. The risks associated with doing business with governmental entities include, but are not limited to, the following:

- Selling to governmental entities can be more competitive, expensive and time consuming than selling to private entities;

- Governmental entities may have significant leverage in negotiations, thereby enabling such entities to demand contract terms that differ from what we generally agree to in our standard agreements, including, for example, most favored nation clauses and terms allowing contract termination for convenience;

- Government demand and payment for our solutions may be influenced by public sector budgetary cycles and funding authorizations, with funding reductions or delays having an adverse impact on public sector demand for our solutions; and

- Government contracts are generally subject to audits and investigations, which we have no experience with, including termination of contracts, refund of a portion of fees received, forfeiture of profits, suspension of payments, fines and suspensions or debarment from future government business.

While our experience dealing with governmental entities has so far been limited, to the extent that we become more reliant on contracts with government clients in the future, our exposure to such risks could increase, which, in turn, could adversely impact our business.

If for any reason we are not able to develop enhancements and new features, keep pace with technological developments or respond to future disruptive technologies, our business will be harmed.

Our future success will depend on our ability to adapt and innovate. To attract new clients and increase revenue from existing clients, we will need to enhance and improve our existing solutions and introduce new features. The success of any enhancement or new feature depends on several factors, including timely completion, introduction and market acceptance. If we are unable to successfully develop or acquire new features or clouds or enhance our existing solutions to meet client needs, our business and operating results will be adversely affected.

In addition, because our solutions are designed to operate on a variety of network, hardware and software platforms using Internet tools and protocols, we will need to continuously modify and enhance our solutions to keep pace with changes in internet-related hardware, software, communication, browser and database technologies. If we are unable to respond in a timely and cost-effective manner to these rapid technological developments, our solutions may become less marketable and less competitive or obsolete, and our operating results may be negatively impacted.

Finally, our ability to grow is subject to the risk of future disruptive technologies. If new technologies emerge that are able to deliver talent management solutions at lower prices, more efficiently or more conveniently, such technologies could adversely impact our ability to compete.

We might require additional capital to support business growth, and this capital might not be available on acceptable terms, if at all.

We intend to continue to make investments to support our business growth and may seek additional funds to respond to business challenges, including the need to develop new features or enhance our existing solutions, improve our operating infrastructure or acquire complementary businesses and technologies. Accordingly, we may need to engage in additional equity or debt financings to secure additional funds. If we raise additional funds through issuances of equity or debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, we may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to support our business growth and to respond to business

challenges could be significantly impaired.

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Ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not generate cash flow from operations in the future sufficient to satisfy our obligations under the notes and any future indebtedness we may incur and to make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance the notes or future indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on the notes or future indebtedness. Conversion of our convertible notes may dilute the ownership interest of existing stockholders, including holders who had previously converted their notes, or may otherwise depress the price of our common stock.

The conversion of some or all of our convertible notes will dilute the ownership interests of existing stockholders to the extent we deliver shares upon conversion of any of the notes. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could be used to satisfy short positions, or anticipated conversion of the notes into shares of our common stock could depress the price of our common stock.

The conditional conversion feature of the notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the notes is triggered, holders of notes will be entitled to convert the notes at any time during specified periods at their option. If one or more holders elect to convert their notes, we would be required to settle a portion of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the notes, may have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, which we refer to as FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the notes to their face amount over the term of the notes. We will report lower net income (or greater net loss) in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the market price of our common stock and the trading price of the notes.

In addition, convertible debt instruments (such as the notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in

accounting for the shares issuable upon conversion of the notes, then our diluted earnings per share would be adversely affected.

If we fail to adequately protect our proprietary rights, our competitive advantage and brand could be impaired and we may lose valuable assets, generate reduced revenue and incur costly litigation to protect our rights.

Our success is dependent, in part, upon protecting our proprietary technology. We rely on a combination of patents, copyrights, trademarks, service marks, trade secret laws and contractual restrictions to establish and protect our proprietary

rights in our products and services. However, the steps we take to protect our intellectual property may be inadequate. We will not be able to protect our intellectual property if we are unable to enforce our rights or if we do not detect unauthorized use of our intellectual property. Despite our precautions, it may be possible for unauthorized third parties to copy our products and use information that we regard as proprietary to create products and services that compete with ours. Some license provisions protecting against unauthorized use, copying, transfer and disclosure of our licensed products may be unenforceable under the laws of certain jurisdictions and foreign countries. Further, the laws of some countries do not protect proprietary rights to the same extent as the laws of the United States. To the extent we expand our international activities, our exposure to unauthorized copying and use of our products and proprietary information may increase.

We enter into confidentiality and invention assignment agreements with our employees and consultants and enter into confidentiality agreements with the parties with whom we have strategic relationships and business alliances. These agreements may not be effective in controlling access to and distribution of our products and proprietary information. Further, these agreements do not prevent our competitors from independently developing technologies that are substantially equivalent or superior to our solutions. Litigation brought to protect and enforce our intellectual property rights could be costly, time consuming and distracting to management and could result in the impairment or loss of portions of our intellectual property. If we fail to secure, protect and enforce our intellectual property rights, we may lose valuable assets, generate reduced revenue and incur costly litigation to protect our rights, which could seriously harm our brand and adversely impact our business.

We may be sued by third parties for alleged infringement of their proprietary rights or may find it necessary to enter into licensing arrangements with third parties to settle or forestall such claims, either of which could have a material adverse effect on our results of operations and financial condition.

There is considerable patent and other intellectual property development activity in our industry. Our success depends in part upon our not infringing the intellectual property rights of others. However, our competitors, as well as a number of other entities and individuals, may own or claim to own intellectual property relating to our industry or, in some cases, our technology or products. From time to time, such third parties may claim that we are infringing their intellectual property rights, and we may actually be found to be infringing such rights. Moreover, we may be subject to claims of infringement with respect to technology that we acquire or license from third parties. The risk that we could be subject to infringement claims is increasing as the number of products and companies competing with our solutions grows. Any claims or litigation could require the commitment of substantial time and resources and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty or licensing payments, indemnify our clients, distributors or other third parties, modify or discontinue the sale of our products, or refund fees, any of which would deplete our resources and adversely impact our business. We have in the past obtained, and may in the future obtain, licenses from third parties to forestall or settle potential claims that our products and technology infringe the intellectual property rights of others. Discussions and negotiations with such third parties, whether successful or unsuccessful, could result in substantial costs and the diversion of management resources, either of which could seriously harm our business.

Indemnity provisions in various agreements potentially expose us to substantial liability for intellectual property infringement and other losses.

Our agreements with clients and other third parties may include indemnification provisions under which we agree to indemnify them for losses suffered or incurred as a result of claims of intellectual property infringement, damages caused by us to property or persons, or other liabilities relating to or arising from our products, services, or other contractual obligations. The term of these indemnity provisions generally survives termination or expiration of the applicable agreement. Large indemnity payments could harm our business, operating results and financial condition. From time to time, we are requested by clients to indemnify them for breach of confidentiality with respect to personal data. Although we normally do not agree to, or contractually limit our liability with respect to, such requests, the existence of such a dispute with a client may have adverse effects on our client relationships and reputation.

We use open source software in our products, which could subject us to litigation or other actions.

We use open source software in our products and may use more open source software in the future. From time to time, there have been claims challenging the ownership of open source software against companies that incorporate open



source software into their products. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software. Litigation could be costly for us to defend, have a negative effect on our operating results and financial condition or require us to devote additional research and development resources to change our products. In addition, if we were to combine our proprietary software products with open source software in a certain manner, we could, under certain of the open source licenses, be required to release the source code of our proprietary software products. If we inappropriately use open source software, we may be required to re-engineer our products, discontinue the sale of our products or take other remedial actions.

We are subject to governmental export and import controls that could impair our ability to compete in international markets due to licensing requirements and subject us to liability if we are not in full compliance with applicable laws. Our solutions are subject to export controls, including the Commerce Department's Export Administration Regulations and various economic and trade sanctions regulations established by the Treasury Department's Office of Foreign Assets Controls, and exports of our solutions must be made in compliance with these laws. If we fail to comply with these U.S. export control laws and import laws, including U.S. Customs regulations, we and certain of our employees could be subject to substantial civil or criminal penalties, including the possible loss of export or import privileges; fines, which may be imposed on us and responsible employees or managers; and, in extreme cases, the incarceration of responsible employees or managers. In addition, if our distributors fail to obtain appropriate import, export or re-export licenses or authorizations, we may also be adversely affected through reputational harm and penalties. Obtaining the necessary authorizations, including any required license, for a particular sale may be time-consuming and is not guaranteed, and may result in the delay or loss of sales opportunities. Furthermore, the U.S. export control laws and economic sanctions laws prohibit the shipment of certain products and services to U.S. embargoed or sanctioned countries, governments and persons. Even though we take precautions to prevent our solutions from being shipped or provided to U.S. sanctions targets, our solutions and services could be shipped to those targets or provided by our distributors despite such precautions. Any such shipment could have negative consequences, including government investigations, penalties and reputational harm. In addition, various countries regulate the import of certain encryption technology, including through import permitting or licensing requirements, and have enacted laws that could limit our ability to distribute our solutions or could limit our clients' ability to implement our solutions in those countries. Changes to our solutions or changes in export and import regulations may create delays in the introduction and sale of our solutions in international markets, prevent our clients with international operations from deploying our solutions or, in some cases, prevent the export or import of our solutions to certain countries, governments or persons altogether. Any change in export or import regulations, economic sanctions or related laws, shift in the enforcement or scope of existing regulations, or change in the countries, governments, persons or technologies targeted by such regulations, could result in decreased use of our solutions, or in our decreased ability to export or sell our solutions to existing or potential clients with international operations. Any decreased use of our solutions or limitation on our ability to export or sell our solutions would likely adversely affect our business, financial condition and results of operations.

Fluctuations in the exchange rate of foreign currencies could result in foreign currency gains and losses.

We currently have foreign sales denominated in Australian Dollars, Canadian Dollars, Euros, Great British Pounds, Indian Rupees, Japanese Yen, New Zealand Dollars, Singapore Dollars, and South African Rand and may in the future have sales denominated in the currencies of additional countries. In addition, we incur a portion of our operating expenses in Great British Pounds and Euros and, to a much lesser extent, in Australian Dollars, Canadian Dollars, Danish Krone, Hong Kong Dollars, Indian Rupees, Israeli New Shekels, New Zealand Dollars, and Swedish Krona. Further, our overseas subsidiaries' results are also impacted by exchange rates affecting the carrying value of U.S. Dollar denominated intercompany loans with us. Any fluctuation in the exchange rate of these foreign currencies may negatively impact our business, financial condition and operating results. We have not previously engaged in foreign currency hedging. If we decide to hedge our foreign currency exposure, we may not be able to hedge effectively due to lack of experience, unreasonable costs or illiquid markets.

We are exposed to fluctuations in the market values of our investments and in interest rates, either of which could impair the market value of our investments and harm our financial results.

At June 30, 2013, we had \$290.3 million in cash and cash equivalents, which primarily consisted of money market funds backed by United States Treasury Bills. In the future, we may invest in short-term marketable securities with maturities of up to one year. Investments are subject to general credit, liquidity, market and interest rate risks, which have been exacerbated by unusual events such as the financial and credit crisis, bankruptcy filings in the United States and the recent debt-ceiling debate, which in turn have affected various sectors of the financial markets and led to global credit and liquidity issues.

Because the market value of fixed-rate debt securities may be adversely impacted by a rise in interest rates, our future investment income may fall short of expectations if interest rates rise. In addition, we may suffer losses if we are

forced to sell securities that have experienced a decline in market value because of changes in interest rates. Currently, we do not use financial derivatives to hedge our interest rate exposure.

The fair value of investments may change significantly due to events and conditions in the credit and capital markets. Any investment securities that we hold, or the issuers of such securities, could be subject to review for possible downgrade. Any downgrade in these credit ratings may result in an additional decline in the estimated fair value of our investments. Changes in the various assumptions used to value these securities and any increase in the perceived market risk associated with such investments may also result in a decline in estimated fair value.

In the event of adverse conditions in the credit and capital markets, and to the extent we make future investments, our investment portfolio may be impacted, and we could determine that some or all of our investments experienced an other-than-

temporary decline in fair value, requiring impairment, which could adversely impact our financial position and operating results.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported results of operations.

A change in accounting standards or practices can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, we retrospectively adopted the amended guidance for revenue recognition for arrangements with multiple deliverables on January 1, 2009, which had a material impact on our financial position and results of operations.

#### Risks Related to Tax Issues

We are a multinational organization faced with increasingly complex tax issues in many jurisdictions, and we could be obligated to pay additional taxes in various jurisdictions.

As a multinational organization, we are subject to taxation in several jurisdictions around the world with increasingly complex tax laws, the application of which can be uncertain. The amount of taxes we pay in these jurisdictions could increase substantially as a result of changes in the applicable tax principles, including increased tax rates, new tax laws or revised interpretations of existing tax laws and precedents, which could have a material adverse effect on our liquidity and results of operations. In addition, the authorities in these jurisdictions could review our tax returns and impose additional tax, interest and penalties, and the authorities could claim that various withholding requirements apply to us or our subsidiaries or assert that benefits of tax treaties are not available to us or our subsidiaries, any of which could have a material impact on us and the results of our operations. The Internal Revenue Service has selected the U.S. federal income tax return for the year ended December 31, 2011 for examination. If the examinations were to uncover incorrect tax positions, we could be subject to additional taxes, interest, and penalties.

Taxing authorities could reallocate our taxable income among our subsidiaries, which could increase our consolidated tax liability.

We conduct operations worldwide through subsidiaries in various tax jurisdictions pursuant to transfer pricing arrangements between our subsidiaries. If two or more affiliated companies are located in different countries, the tax laws or regulations of each country generally will require that transfer prices be the same as those between unrelated companies dealing at arms' length and that contemporaneous documentation is maintained to support the transfer prices. While we believe that we operate in compliance with applicable transfer pricing laws and intend to continue to do so, our transfer pricing procedures are not binding on applicable tax authorities. If tax authorities in any of these countries were to successfully challenge our transfer prices as not reflecting arm's length transactions, they could require us to adjust our transfer prices and thereby reallocate our income to reflect these revised transfer prices, which could result in a higher tax liability to us. In addition, if the country from which the income is reallocated does not agree with the reallocation, both countries could tax the same income, resulting in double taxation. If tax authorities were to allocate income to a higher tax jurisdiction, subject our income to double taxation or assess interest and penalties, it would increase our consolidated tax liability, which could adversely affect our financial condition, results of operations and cash flows.

Our ability to use net operating loss carryforwards to reduce future tax payments may be limited if we experience a change in ownership, or if taxable income does not reach sufficient levels.

Under Section 382 of the Internal Revenue Code of 1986, as amended, if a corporation undergoes an "ownership change" (generally defined as a greater than 50% change (by value) in its equity ownership over a three year period), the corporation's ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes (such as research tax credits) to offset its post-change income may be limited. We may experience ownership changes in the future and subsequent shifts in our stock ownership. As a result, we may be limited in the portion of net operating loss carryforwards that we can use in the future to offset taxable income for U.S. Federal income tax purposes.

#### Risks Related to Ownership of our Common Stock

An active trading market for our common stock may not be sustained, and the trading price of our common stock may be volatile.

Our shares of common stock began trading on the NASDAQ Global Market on March 17, 2011. Given the limited trading history of our common stock, there is a risk that an active trading market for our common stock will not be sustained,

which could put downward pressure on the market price of our common stock and thereby affect the ability of our stockholders to sell their shares. In addition, the trading price of our common stock has at times been volatile and could continue to be subject to significant fluctuations in response to various factors, some of which are beyond our control. For example, after opening at \$13.00 per share upon the commencement of our initial public offering, our common stock has experienced an intra-day trading high of \$48.49 per share and an intra-day trading low of \$11.50 per share. In addition, the stock market in general, and the market for technology companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of the companies operating in such markets. The market price of our common stock may be similarly volatile, and investors in our common stock may experience a decrease in the value of their shares, including as a result of factors unrelated to our operating performance and prospects. The price of our common stock could be subject to wide fluctuations in response to a number of factors, including:

- our operating performance and the performance of other similar companies;
- the overall performance of the equity markets;
- developments with respect to intellectual property rights;
- publication of unfavorable research reports about us or our industry or withdrawal of research coverage by securities analysts;
- speculation in the press or investment community;
- the size of our public float;
- natural disasters or terrorist acts;
- announcements by us or our competitors of significant contracts, new technologies, acquisitions, commercial relationships, joint ventures or capital commitments; and
- global economic, legal and regulatory factors unrelated to our performance.

If securities or industry analysts do not publish research or publish misleading or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who covers us downgrade our stock or publish incorrect or unfavorable research about our business, our stock price would likely decline. In addition, if one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price or trading volume to decline.

We incur significant costs and demands upon management as a result of complying with the laws and regulations affecting public companies, which could adversely affect our operating results.

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company, including costs associated with public company reporting and corporate governance requirements. These requirements include compliance with Section 404 and other provisions of the Sarbanes-Oxley Act, as well as rules implemented by the SEC and the NASDAQ Global Market. If these requirements divert our management's attention from other business concerns, they could have a material adverse effect on our business, prospects, financial condition and operating results. In addition, complying with these rules and regulations has substantially increased our legal and financial compliance expenses, has made some activities more time-consuming and costly, and may in the future require us to reduce costs in other areas of our business or increase the prices of our solutions, which could negatively impact our business.

Our principal stockholders have a controlling influence over our business affairs and may make business decisions with which our stockholders disagree and which may adversely affect the value of our stockholders' investment. As of June 30, 2013, our executive officers and directors beneficially owned, in the aggregate, approximately 18% of our outstanding common stock. As a result, if some of these persons or entities act together, they will have the ability to significantly influence matters submitted to our stockholders for approval, including the election and removal of directors, amendments to our certificate of incorporation and bylaws and the approval of any business combination. This concentration of ownership may also have the effect of delaying or preventing a change of control of our company or discouraging others from making tender offers for our shares, which could prevent our stockholders from receiving a premium for their shares.



The issuance of additional stock in connection with acquisitions, our stock incentive plans, warrants or otherwise will dilute all other stockholdings.

Our certificate of incorporation authorizes us to issue up to 1,000,000,000 shares of common stock and up to 50,000,000 shares of preferred stock with such rights and preferences as may be determined by our board of directors. Subject to compliance with applicable rules and regulations, we may issue all of these shares that are not already outstanding without any action or approval by our stockholders. We intend to continue to evaluate strategic acquisitions in the future. We may pay for such acquisitions, partly or in full, through the issuance of additional equity. For example, in our acquisition of Sonar Limited, we issued an aggregate of 46,694 shares of our common stock. Any issuance of shares in connection with our acquisitions, the exercise of stock options or warrants, the vesting of restricted stock units or otherwise would dilute the percentage ownership held by existing investors. We do not expect to declare any dividends in the foreseeable future.

We do not anticipate declaring any cash dividends to holders of our common stock in the foreseeable future. Consequently, investors may need to sell all or part of their holdings of our common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

Anti-takeover provisions in our charter documents and Delaware law may delay or prevent an acquisition of our company.

Our certificate of incorporation, bylaws and Delaware law contain provisions that may have the effect of delaying or preventing a change in control of us or changes in our management. Our certificate of incorporation and bylaws include provisions that:

- authorize “blank check” preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock;
- create a classified board of directors whose members serve staggered three-year terms;
- specify that special meetings of our stockholders can be called only by our board of directors, the chairperson of the board, the chief executive officer or the president;
- establish an advance notice procedure for stockholder approvals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to our board of directors;
- provide that our directors may be removed only for cause;
- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum;
- specify that no stockholder is permitted to cumulate votes at any election of directors; and
- require supermajority votes of the holders of our common stock to amend specified provisions of our charter documents.

These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us.

Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

To the extent that our pre-tax income or loss becomes relatively modest, our ability to conclude that a control deficiency is not a material weakness or that an accounting error does not require a restatement could be adversely affected.

Under the Sarbanes-Oxley Act of 2002, our management is required to assess the impact of control deficiencies based upon both quantitative and qualitative factors, and depending upon that analysis we classify such identified deficiencies as either a control deficiency, significant deficiency or a material weakness. One element of our analysis of the significance of any control deficiency is its actual or potential financial impact. This assessment will vary depending on our level of pre-tax income or loss. For example, a smaller pre-tax income or loss will increase the



likelihood of a quantitative assessment of a control deficiency as a significant deficiency or material weakness. To the extent that our pre-tax income or loss is relatively small, if management or our independent registered public accountants identify an error in our interim or annual financial statements, it is more likely that such an error may be

determined to be a material weakness or be considered a material error that could, depending upon the complete quantitative and qualitative analysis, result in our having to restate previously issued financial statements.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Recent Sales of Unregistered Securities

None.

(b) Use of Proceeds

Our initial public offering of common stock was effected through a Registration Statement on Form S-1 (File No. 333-169621) that was declared effective by the SEC on March 16, 2011.

There has been no material change in the use of proceeds from our initial public offering as described in our final prospectus filed with the SEC pursuant to Rule 424(b) and other periodic reports previously filed with the SEC.

ITEM 3. Defaults Upon Senior Securities

None.

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ITEM 4. Mine Safety Disclosures

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

See the Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

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SIGNATURE

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

Cornerstone OnDemand, Inc.  
(Registrant)

/s/ Adam L. Miller  
Adam L. Miller  
President and Chief Executive Officer  
Date: August 7, 2013

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## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date
		Form	File No.	Exhibit	
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	S-1/A	333-169621	3.2	November 9, 2010
3.2	Amended and Restated Bylaws of the Registrant.	S-1/A	333-169621	3.4	November 9, 2010
4.1	Indenture between the Registrant and U.S. Bank National Association, dated as of June 17, 2013.	8-K	001-35098	4.1	June 17, 2013
10.1*	Description of 2013 Executive Bonus Plan.	8-K	001-35098	n/a	April 30, 2013
10.2*	2013 Sales Commission Plan between the Registrant and David J. Carter.				
10.3*	2013 Sales Commission Plan between the Registrant and Vincent Belliveau.				
10.4*	Form of Change of Control Severance Agreement between the Registrant and each of Mark Goldin, David Carter and Kirsten Maas Helvey.				
10.5	Form of Convertible Bond Hedge Confirmation.	8-K	001-35098	10.2	June 17, 2013
10.6	Form of Warrant Confirmation.	8-K	001-35098	10.3	June 17, 2013
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
32.1†	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.				
32.2†	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.				
101.INS††	XBRL Instance Document				
101.SCH††	XBRL Taxonomy Extension Schema Document				
101.CAL††	XBRL Taxonomy Extension Calculation Linkbase Document				
101.DEF††	XBRL Taxonomy Extension Definition Linkbase Document				
101.LAB††	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE††	XBRL Taxonomy Extension Presentation Linkbase Document				

\* Indicates a management contract or compensatory plan or arrangement.

† The certifications attached as Exhibit 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Cornerstone OnDemand, Inc. under the Securities Act of 1933, as amended, or the Securities

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Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

†† XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not otherwise subject to liability under these sections.