PROOFPOINT INC
Form 10-Q
August 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2015
OR

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

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

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

(408) 517-4710

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES þ NO o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ Shares of Proofpoint, Inc. common stock, $0.0001 par value per share, outstanding as of July 24, 2015:

40,018,939 shares.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.
Proofpoint, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except per share amounts)
(Unaudited)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$402,144	$180,337
Short-term investments	8,510	34,649
Accounts receivable, net of allowance for doubtful accounts of $177 and $429 as of June 30, 2015 and December 31, 2014, respectively	44,298	40,912
Inventory	435	499
Deferred product costs	1,881	1,847
Prepaid expenses and other current assets	8,175	7,994
Total current assets	465,443	266,238
Property and equipment, net	26,774	18,718
Deferred product costs	614	307
Goodwill	126,525	107,504
Intangible assets, net	33,962	27,086
Other assets	3,872	4,163
Total assets	$657,190	$424,016
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$12,977	$9,249
Accrued liabilities	24,573	24,220
Equipment loans and capital lease obligations	2	695
Deferred rent	486	569
Deferred revenue	142,087	123,550
Total current liabilities	180,125	158,283
Convertible senior notes	335,728	161,396
Long-term deferred rent	1,986	2,099
Other long-term liabilities	5,177	6,640
Long-term deferred revenue	41,854	39,125
Total liabilities	564,870	367,543
Commitments and contingencies (note 5)		
Stockholders’ equity:		
Convertible preferred stock, $0.0001 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value; 200,000 shares authorized; 39,897 and 38,665 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively	4	4
Additional paid-in capital	413,212	330,744
Accumulated other comprehensive loss	(2)	(27)
Accumulated deficit	(320,894)	(274,248)

Total stockholders’ equity	92,320	56,473
Total liabilities and stockholders’ equity	$657,190	$424,016

See accompanying Notes to the Condensed Consolidated Financial Statements.

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

	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Revenue:				
Subscription	$61,778	$45,047	$117,634	$86,251
Hardware and services	1,768	1,351	3,675	2,851
Total revenue	63,546	46,398	121,309	89,102
Cost of revenue:(1)(2)				
Subscription	16,829	12,544	33,163	23,995
Hardware and services	2,995	2,717	5,949	4,977
Total cost of revenue	19,824	15,261	39,112	28,972
Gross profit	43,722	31,137	82,197	60,130
Operating expense:(1)(2)				
Research and development	18,659	12,298	34,367	24,246
Sales and marketing	38,017	24,180	70,929	46,998
General and administrative	8,495	6,846	15,828	12,352
Total operating expense	65,171	43,324	121,124	83,596
Operating loss	(21,449)	(12,187)	(38,927)	(23,466)
Interest expense	(3,332)	(2,798)	(6,185)	(5,571)
Other income (expense), net	(80)	7	(1,260)	(192)
Loss before provision for income taxes	(24,861)	(14,978)	(46,372)	(29,229)
Provision for income taxes	(112)	(147)	(274)	(291)
Net loss	$(24,973)	$(15,125)	$(46,646)	$(29,520)
Net loss per share, basic and diluted	$(0.63)	$(0.41)	$(1.19)	$(0.80)
Weighted average shares outstanding, basic and diluted	39,567	37,115	39,264	36,842
(1) Includes stock based compensation expense as follows:				
Cost of subscription revenue	$1,148	$511	$2,263	$923
Cost of hardware and services revenue	250	144	504	273
Research and development	5,762	2,450	9,700	4,484
Sales and marketing	5,157	2,408	10,026	4,505
General and administrative	2,918	1,815	5,168	3,116
(2) Includes intangible amortization expense as follows:				
Cost of subscription revenue	$1,589	$974	$2,969	$1,803
Research and development	23	24	46	47
Sales and marketing	1,304	1,100	2,597	2,197
General and administrative	1	11	12	22

See accompanying Notes to the Condensed Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net loss	$(24,973)	$(15,125)	$(46,646)	$(29,520)
Other comprehensive loss, net of tax:				
Unrealized gains on short-term investments, net	5	—	25	—
Comprehensive loss	$(24,968)	$(15,125)	$(46,621)	$(29,520)

See accompanying Notes to the Condensed Consolidated Financial Statements.

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

	Six Months Ended June 30, 2015	2014
Cash flows from operating activities		
Net loss	$(46,646)	$(29,520)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,427	8,105
Loss on disposal of property and equipment	115	—
Amortization of investment premiums, net of accretion of purchase discounts	206	15
Provision for allowance for doubtful accounts	(252)	(5)
Stock based compensation	27,661	13,301
Deferred income taxes	144	(70)
Change in fair value of contingent earn-outs	—	5
Amortization of debt issuance costs and accretion of debt discount	4,962	4,316
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(2,014)	(47)
Inventory	64	(483)
Deferred products costs	(341)	(995)
Prepaid expenses	(782)	(1,461)
Other current assets	585	(765)
Long-term assets	109	(78)
Accounts payable	825	(462)
Accrued liabilities	(2,855)	(3,376)
Earn-out payment	—	(5)
Deferred rent	(221)	1,123
Deferred revenue	20,566	7,580
Net cash provided by (used in) operating activities	13,553	(2,822)
Cash flows from investing activities		
Proceeds from sales and maturities of short-term investments	25,959	8,000
Purchase of property and equipment	(10,427)	(6,023)
Acquisitions of businesses, net of cash acquired	(31,624)	(22,754)
Net cash used in investing activities	(16,092)	(20,777)
Cash flows from financing activities		
Proceeds from issuance of common stock	9,676	8,671
Withholding taxes related to restricted stock net share settlement	(8,427)	(752)
Payments of debt issuance costs	—	(191)
Repayments of notes payable and loans	(693)	(825)
Proceeds from issuance of convertible senior notes, net of discount	223,790	—
Earn-out payment	—	(245)
Net cash provided by financing activities	224,346	6,658
Net increase (decrease) in cash and cash equivalents	221,807	(16,941)
Cash and cash equivalents		
Beginning of period	180,337	243,786

End of period	$402,144	$226,845
Supplemental disclosure of noncash investing and financing information		
Unpaid purchases of property and equipment	$5,949	$3,154

See accompanying Notes to the Condensed Consolidated Financial Statements.

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

1. The Company and Summary of Significant Accounting Policies

The Company

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

Basis of Presentation and Consolidation

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

The Company acquired one company in the six months ended June 30, 2015 and two companies in the year ended December 31, 2014. These acquisitions are more fully described in note 2, "Acquisitions". The consolidated financial statements include the results of operations from these business combinations from their date of acquisition.

The accompanying condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”), pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and note disclosures have been condensed or omitted pursuant to such rules and regulations. The accompanying Condensed Consolidated Balance Sheet as of December 31, 2014 is derived from audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair statement of the periods presented. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015 or for other interim periods or for future years.

These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and accompanying notes for the year ended December 31, 2014 included in the Company’s Annual Report on Form 10-K filed with the SEC. The Company’s significant accounting policies are described in note 1 to those audited consolidated financial statements.

Use of Estimates

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

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price of the acquired enterprise over the fair value of identifiable assets acquired and liabilities assumed. The Company performs an annual goodwill impairment test during the fourth quarter of a calendar year and more frequently if an event or circumstances indicates that impairment may have occurred. For the purposes of impairment testing, the Company has determined that it has one operating segment and one reporting unit. The Company

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performs a two-step impairment test of goodwill whereby the fair value of the reporting unit is compared to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not considered impaired and further testing is not required. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then impairment loss equal to the difference is recorded. The identification and measurement of goodwill impairment involves the estimation of the fair value of the Company. The estimate of fair value of the Company, based on the best information available as of the date of the assessment, is subjective and requires judgment, including management assumptions about expected future revenue forecasts and discount rates, changes in the overall economy, trends in the stock price and other factors. No impairment indicators were identified by the Company as of June 30, 2015.

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

Intangible assets are amortized on a straight-line basis over their estimated lives, which approximate the pattern in which the economic benefits of the intangible assets are consumed, as follows (in years):

	Low	High
Patents	4	5
Developed technology	3	7
Customer relationships	2	7
Non-compete agreements	2	4
Order backlog	1	2
Trade names and trademarks	1	5

In-process research and development asset is not amortized until the associated project is completed.

Revenue Recognition

The Company derives its revenue primarily from two sources: (1) subscription revenue for rights related to the use of the security-as-a-service platform and (2) hardware, training and professional services revenue provided to customers related to their use of the platform. The Company records its revenues net of any value added or sales tax.

Subscription revenue is derived from a subscription based enterprise licensing model with contract terms typically ranging from one to three years, and consists of (i) subscription fees from the licensing of the security-as-a-service platform, (ii) subscription fees for access to the on-demand elements of the platform and (iii) subscription fees for the right to access the Company's customer support services.

Revenue is recognized when all of the following criteria have been met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services have been rendered;
- Sales price is fixed or determinable; and
- Collectability is reasonably assured

The Company's revenue arrangements typically include subscription services to its security-as-a-service platform. These hosted on demand service arrangements do not provide customers with the right to take possession of the software supporting the hosted services. Certain arrangements also include the sale of hardware appliances. Revenue from hardware appliances containing software components and hardware components that function together to deliver the hardware appliance's essential functionality is excluded from the scope of the industry specific revenue recognition guidance. The Company recognizes revenue from its hosted on demand services in accordance with general revenue recognition accounting guidance. Only revenue derived from the licensing of the software is recognized in accordance with the industry specific revenue guidance.

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

When a sales arrangement contains multiple elements, such as hardware appliances, subscription services, customer support services, and/or professional services, the Company allocates revenue to each unit of accounting or element based on a selling price hierarchy. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company's control. When applying the relative selling price method, the Company determines the selling price for each deliverable using vendor-specific objective evidence (“VSOE”) of selling price. If VSOE does not exist, the Company uses third-party evidence (“TPE”) of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, the Company uses its best estimate of selling price ("BESP") for that deliverable. Revenue allocated to each element is then recognized when the basic revenue recognition criteria are met for each element. The Company determines BESP for an individual element within a multiple element revenue arrangement using the same methods utilized to determine the selling price of an element sold on a standalone basis. The Company estimates the selling price for its subscription solutions by considering internal factors such as historical pricing practices and it estimates the selling price of hardware and other services using a cost plus model.

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

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

The Company assesses collectability based on a number of factors, including credit worthiness of the customer and past transaction history of the customer. Through June 30, 2015, the Company has not experienced significant credit losses.

Deferred Revenue

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

Comprehensive Loss

Comprehensive loss includes all changes in equity that are not the result of transactions with stockholders. The Company's comprehensive loss consists of its net loss and changes in unrealized gains (losses) from its available-for-sale investments. The Company had no material reclassifications out of accumulated other comprehensive loss into net loss for the three and six months ended June 30, 2015 and 2014.

Recent Accounting Policies

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In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03), which requires the Company to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. ASU 2015-03 is effective for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years, with early adoption permitted. The Company early adopted this ASU effective during the second quarter of 2015 and has applied it retrospectively to all prior periods presented. Consequently, other long-term assets and convertible senior notes liabilities as of December 31, 2014 included in the consolidated balance sheet herein were reduced by $234. There was no impact on the Company's results of operations or cash flows due to the adoption of this standard.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Originally, ASU 2014-09 was effective for the Company starting January 1, 2017 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. In July 2015, the FASB voted to amend ASU 2014-09 by approving a one-year deferral of the effective date as well as providing the option to early adopt the standard on the original effective date. The Company is currently evaluating the timing and impact of the adoption of ASU 2014-09 on its consolidated financial statements.

2. Acquisitions

Acquisitions are accounted for under the purchase method of accounting in which the tangible and identifiable intangible assets and liabilities of each acquired company are recorded at their respective fair values as of each acquisition date, including an amount for goodwill representing the difference between the respective acquisition consideration and fair values of identifiable net assets. The Company believes that for each acquisition, the combined entities will achieve savings in corporate overhead costs and opportunities for growth through expanded geographic and customer segment diversity with the ability to leverage additional products and capabilities. These factors, among others, contributed to a purchase price in excess of the estimated fair value of each acquired company's net identifiable assets acquired and, as a result, goodwill was recorded in connection with each acquisition. Goodwill related to each acquisition below, other than Emerging Threats Pro, LLC, is not deductible for tax purposes.

While the Company uses its best estimates and assumptions as part of the purchase price allocation process to value assets acquired and liabilities assumed at the acquisition date, these estimates and assumptions are subject to refinement. When additional information becomes available, such as finalization of negotiations of working capital adjustments and tax related matters, the Company may revise its preliminary purchase price allocation. As a result, during the preliminary purchase price allocation period, which may be up to one year from the acquisition date, the Company may record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Subsequent to the purchase price allocation period, adjustments to assets acquired or liabilities assumed are recognized in the operating results.

During the six months period ended June 30, 2015 and for the year ended December 31, 2014, the Company acquired a total of 3 companies (collectively, the "Acquisitions") which are further described below.

Emerging Threats Pro, LLC

On March 6, 2015 (the "Emerging Threats Acquisition Date"), pursuant to the terms of a Purchase Agreement, the Company acquired 100% of membership interests in Emerging Threats Pro, LLC ("Emerging Threats"). Based in Indianapolis, Indiana, Emerging Threats provides threat intelligence solutions to help protect networks from known or potentially malicious threats. With this acquisition, the Company intends to integrate Emerging Threat's advanced threat intelligence solutions with its existing Targeted Attack Protection and Threat Response security solutions to advance threat detection and response across the completed attack chain. The combined technology will provide customers with deeper insight into cyberthreats, enabling them to react faster to inbound cyberattacks, and to identify, block, and disable previously undetected malware already embedded in their organizations.

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The Company has provisionally estimated the fair values for the acquired tangible and identifiable intangible assets and liabilities assumed at the Emerging Threats Acquisition Date. The amounts reported were considered provisional as the Company was completing the valuation work to determine the fair value of certain assets acquired and liabilities assumed. The results of operations and the provisional fair values of the acquired assets and liabilities assumed have been included in the accompanying condensed consolidated financial statements since the Emerging Threat Acquisition Date. Revenue from Emerging Threats was not material for the three and six months ended June 30, 2015, and due to the continued integration of the combined businesses, it was impractical to determine the earnings.

The total purchase price was $31,803, net of cash acquired of $52, of which $3,662 was paid in the second quarter of 2015. Of the cash consideration paid, $6,000 was held in escrow, to secure indemnification obligations, which has not been released as of the filing date of this Quarterly Report on Form 10-Q. The Company incurred $275 in acquisition-related costs which were recorded within operating expenses for the six months ended June 30, 2015.

Fair value of acquired assets and liabilities assumed

The determination of the fair values of the assets acquired and liabilities assumed has been prepared on a provisional basis and changes to that determination may occur as additional information becomes available. The following table summarizes the fair values of tangible and intangible assets acquired, liabilities assumed and goodwill:

	Estimated Fair Value	Estimated Useful Life (in years)
Current assets acquired	$1,284	N/A
Fixed assets acquired	174	N/A
Liabilities assumed	(448)	N/A
Deferred revenue assumed	(700)	N/A
Holdback liability to the sellers	(3,662)	N/A
Trade names	200	2
Customer relationships	4,200	7
Order Backlog	200	1
Developed technology	7,900	7
Goodwill	19,045	Indefinite
	$28,193	

Nexgate, Inc.

On October 31, 2014 (the "Nexgate Acquisition Date"), pursuant to the terms of an Agreement and Plan of Merger, a wholly-owned subsidiary of the Company merged with and into Nexgate, Inc. ("Nexgate"), with Nexgate surviving as a wholly-owned subsidiary of the Company. Formerly based in Burlingame, California, Nexgate provides cloud-based brand protection and compliance for enterprise social media accounts. With this acquisition, the Company's customers can effectively protect their online brand presence and social media communication infrastructure. Nexgate technology identifies and remediates fraudulent social media accounts, account hacks, and content that contains malware, spam and abusive language. In addition, the Nexgate solution enforces policy on authorized accounts and posts for compliance with a wide-range of social media regulatory requirements.

The Company has provisionally estimated the fair values for the acquired tangible and identifiable intangible assets and liabilities assumed at the Nexgate Acquisition Date. The amounts reported were considered provisional as the

Company was completing the valuation work to determine the fair value of certain assets acquired and liabilities assumed.

The results of operations and the provisional fair values of the acquired assets and liabilities assumed have been included in the accompanying consolidated financial statements since the Nexgate Acquisition Date.

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At the Nexgate Acquisition Date, the Company paid $31,771 in cash consideration, net of cash acquired of $1,032. Of the cash consideration paid, $5,250 was held in escrow to secure indemnification obligations, which has not been released as of the filing date of this Quarterly Report on Form 10-Q.

Fair value of acquired assets and liabilities assumed

The determination of the fair values of the assets acquired and liabilities assumed has been prepared on a provisional basis and changes to that determination may occur as additional information becomes available. The following table summarizes the fair values of tangible assets acquired, liabilities assumed, intangible assets and goodwill:

	Estimated Fair Value	Estimated Useful Life (in years)
Current assets acquired	$ 1,340	N/A
Fixed assets acquired	15	N/A
Liabilities assumed	(64)	N/A
Deferred revenue assumed	(600)	N/A
Customer relationships	3,000	7
Order backlog	200	2
Developed technology	3,200	4
In-process research and development	900	N/A
Deferred tax liability, net	(792)	N/A
Goodwill	25,604	Indefinite
	$ 32,803	

NetCitadel, Inc.

On May 13, 2014 (the "NetCitadel Acquisition Date"), pursuant to the terms of an Agreement and Plan of Merger, a wholly-owned subsidiary of the Company merged with and into NetCitadel, Inc. ("NetCitadel"), with NetCitadel surviving as a wholly-owned subsidiary of the Company. Formerly based in Mountain View, California, NetCitadel is a pioneer in the field of automated security incident response. The acquisition extends the reach and capabilities of the Company's existing advanced threat solutions, adding additional threat verification and containment capabilities via an open platform that unifies products from the Company and other vendors.

The results of operations and the fair values of the acquired assets and liabilities assumed have been included in the accompanying consolidated financial statements since the NetCitadel Acquisition Date.

At the NetCitadel Acquisition Date, the Company paid $22,731. Of the cash consideration paid, $3,369 was held in escrow to secure indemnification obligations, which has not been released as of the filing date of this Form 10-Q.

Fair value of acquired assets and liabilities assumed

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

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	Fair Value	Estimated Useful Life
Tangible assets acquired	$14	N/A
Liabilities assumed	(1,267)	N/A
Customer relationships	100	5
Developed technology	5,500	5
Goodwill	18,384	Indefinite
	$22,731	

Pro Forma Financial Information

The following unaudited pro forma financial information presents the combined results of operations for the three and six months ended June 30, 2015 and 2014 of the Company, Emerging Threats, assuming that Emerging Threats was acquired as of January 1, 2014, and NetCitadel, assuming that NetCitadel was acquired as of January 1, 2013. Adjustments were made to give effect to pro forma events that are directly attributable to the acquisitions such as amortization expense of acquired intangible assets, stock-based compensation directly attributable to the acquisition and acquisition-related transaction costs. The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings which may result from the consolidation of the operations of the Company and acquired businesses. Accordingly, these unaudited pro forma results are presented for informational purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the acquisitions had occurred at the beginning of the period presented, nor are they indicative of future results of operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Total revenue	$63,335	$47,274	$121,104	$90,719
Net loss	(24,923)	(16,304)	(48,116)	(32,150)
Basic and diluted net loss per share	$(0.63)	$(0.44)	$(1.23)	$(0.87)

The unaudited pro forma financial information includes non-recurring acquisition-related transaction costs of $275 for the six months ended June 30, 2014.

3. Goodwill and Intangible Assets

The goodwill activity and balances are presented below:

Balance at December 31, 2014	$107,504
Add: Goodwill from acquisitions	19,395
Less: Other purchase price allocation adjustments to Goodwill	(374)
Balance at June 30, 2015	$126,525

The goodwill balance as of June 30, 2015 was the result of the Company's acquisitions.

Intangible Assets

Intangible assets, excluding goodwill, consisted of the following:

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	June 30, 2015			December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$46,068	$(24,508)	$21,560	$38,168	$(21,538)	$16,630
Customer relationships	20,582	(10,192)	10,390	16,382	(7,893)	8,489
Non-compete agreements	804	(594)	210	804	(462)	342
Trade names and patents	1,006	(374)	632	806	(264)	542
Order backlog	400	(130)	270	200	(17)	183
In-process research and development	900	—	900	900	—	900
	$69,760	$(35,798)	$33,962	$57,260	$(30,174)	$27,086

Amortization of intangible assets expense was $2,917 and $2,109 for the three months ended June 30, 2015 and 2014, respectively, and $5,624 and $4,069 for the six months ended June 30, 2015 and 2014, respectively.

Future estimated amortization of intangible assets expense as of June 30, 2015 are presented below:

Year ending December 31,	
2015, remainder	$5,637
2016	9,288
2017	5,944
2018	5,348
2019	3,095
Thereafter	4,650
	$33,962

4. Fair Value Measurements and Investments

Fair Value Measurements

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

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

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

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

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

The Company’s Level 2 assets and liabilities generally consist of corporate debt securities, commercial papers, certificates of deposit and convertible senior notes.

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

The following tables summarize, for each category of assets or liabilities carried at fair value, the respective fair value as of June 30, 2015 and December 31, 2014 and the classification by level of input within the fair value hierarchy:

	Balance as of June 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets				
Cash equivalents:				
Money market funds	$386,872	$386,872	$—	$—
Short-term investments:				
Corporate debt securities	8,510	—	8,510	—
Total financial assets	$395,382	$386,872	$8,510	$—

	Balance as of December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets				
Cash equivalents:				
Money market funds	$139,644	$139,644	$—	$—
Short-term investments:				
Corporate debt securities	31,651	—	31,651	—
Commercial papers	2,998	—	2,998	—
Total financial assets	$174,293	$139,644	$34,649	$—

Based on quoted market prices as of June 30, 2015, the fair values of the 0.75% and 1.25% Convertible Senior Notes were approximately $340,694 and $248,812, respectively, determined using Level 2 inputs as they are not actively traded in markets.

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

Investments

The cost and fair value of the Company’s cash and cash equivalents and available-for-sale investments as of June 30, 2015 and December 31, 2014 were as follows:

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	June 30, 2015			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$15,272	$—	$—	$15,272
Money market funds	386,872	—	—	386,872
Total	$402,144	$—	$—	$402,144
Short-term investments:				
Corporate debt securities	$8,512	$—	$(2)	$8,510
Total	$8,512	$—	$(2)	$8,510

	December 31, 2014			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$40,693	$—	$—	$40,693
Money market funds	139,644	—	—	139,644
Total	$180,337	$—	$—	$180,337
Short-term investments:				
Corporate debt securities	$31,678	$—	$(27)	$31,651
Certificate of deposit	2,998	—	—	2,998
Total	$34,676	$—	$(27)	$34,649

As of June 30, 2015 and December 31, 2014, all investments mature in less than one year. Estimated fair values for marketable securities are based on quoted market prices for the same or similar instruments.

5. Commitments and Contingencies

Operating Leases

The Company leases certain of its facilities under noncancellable operating leases with various expiration dates through May 2025.

Premises rent expense was $951 and $860 for the three months ended June 30, 2015 and 2014, respectively, and $1,818 and $1,398 for the six months ended June 30, 2015 and 2014, respectively.

Capital Leases

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

At June 30, 2015, future annual minimum lease payments under noncancellable operating and capital leases were as follows:

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	Capital Leases	Operating Leases
Year ending December 31,		
2015, remainder	$2	$4,032
2016	—	7,343
2017	—	3,915
2018	—	3,816
2019	—	3,643
Thereafter	—	1,291
Total minimum lease payments	2	$24,040
Less: Amount representing interest	—	
Present value of capital lease obligations	2	
Less: current portion	(2)	
Long-term portion of capital lease obligations	$—	

Contingencies

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

Legal Contingencies

From time to time, the Company may be involved in legal proceedings and subject to claims in the ordinary course of business. On December 16, 2013, Finjan, Inc. sued the Company and its wholly-owned subsidiary, Armorize Technologies, Inc., in the United States District Court, Northern District of California for alleged patent infringement of a variety of its patents, demanding preliminary and permanent injunctive relief, and unspecified damages. The Company and Armorize filed an answer to the complaint on February 10, 2014. On April 15, 2014, Finjan’s initial disclosures in the lawsuit alleged approximately $13,500 in damages, but provided no basis or facts in support of this sum. On April 2, 2015, the court ordered that the claims construction hearing be held in June 2015 and trial be set for March 2016, subject to alteration only upon a showing of good cause. On April 2, 2015, the court ordered that the claims construction hearing be held in June 2015 and trial be set for March 2016, subject to later adjustment or delay. On April 2, 2015, the court also ordered in part that Finjan amend its infringement contentions to comply with the Patent Local Rules by April 23, 2015. On April 23, 2015, Finjan amended its infringement contentions. On June 24, 2015, the court held the claims construction hearing in this matter and the court’s ruling is now pending. Based on the state of the infringement contentions and evaluation of the facts available at this time, the amount or range of reasonable possible losses to which the Company or Armorize is exposed cannot be estimated and the ultimate resolution of this matter and the associated financial statement impact, if any, remains uncertain at this time. The Company and Armorize intend to vigorously defend the lawsuit. Intellectual property litigation is subject to inherent uncertainties, and there can be no assurance that the expenses associated with defending any litigation or the resolution of this dispute would not have a material adverse impact on the Company's results of operations or cash flows. Regardless of the outcome, such proceedings and claims can have an adverse impact on the Company because of defense and settlement costs, diversion of resources and other factors, and there can be no assurances that favorable outcomes will be obtained.

6. Convertible Senior Notes

0.75% Convertible Senior Notes due June 2020

On June 17, 2015, the Company issued $200,000 principal amount of 0.75% Convertible Senior Notes (the "0.75% Notes") due 2020 in a private offering to qualified institutional buyers ("Holders") pursuant to Rule 144A under the Securities Act of 1944 (the "Exchange Act"), as amended. The initial Holders of the 0.75% Notes also had an option to purchase an

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additional $30,000 in principal amount which was exercised in full. The net proceeds after the agent's discount and issuance costs of $6,581 from the 0.75% Notes offering were approximately $223,419. The Company will use the net proceeds for working capital and general corporate purposes, which may include funding the Company's operations, capital expenditures, potential acquisitions of businesses, products or technologies believed to be of strategic importance. The 0.75% Notes bear interest at 0.75% per year, payable semi-annually in arrears every June 15 and December 15, beginning on December 15, 2015.

The 0.75% Notes are unsecured and rank senior in right of payment to any indebtedness expressly subordinated in right of payment to the 0.75% Notes. They rank equally with the Company's other existing and future unsecured indebtedness that is not subordinated and are structurally subordinated to any current or future secured indebtedness to the extent of the value of the assets securing the indebtedness and other liabilities of the Company's subsidiaries.

The initial conversion rate is 12.3108 shares of the Company’s common stock per $1 principal amount of notes which equates to 2,831 shares of common stock, or a conversion price equivalent of $81.23 per share of common stock. Throughout the term of the 0.75% Notes, the conversion rate may be adjusted upon the occurrence of certain events, such as the payment of cash dividends or issuance of stock warrants. The 0.75% Notes mature on June 15, 2020, unless repurchased, redeemed or converted in accordance with their terms prior to such date.

At the Company's option, on or after June 20, 2018, the Company will be able to redeem all or a portion of the 0.75% Notes at 100% of the principal amount, plus any accrued and unpaid interest, under certain conditions. The Company may redeem the 0.75% Notes in shares of the Company’s common stock, cash, or some combination of each.

Prior to December 15, 2019, the 0.75% Notes will be convertible at the option of the Holders only upon the satisfaction of certain conditions and during certain periods if any of the following events occur:

- during the calendar quarter commencing after September 30, 2015, if the last reported sale price of the Company's common stock is greater than or equal to 130% of the applicable conversion price on each such trading day for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter;
- during the 5 business day period after any 5 consecutive trading day period in which the trading price, as defined, per $1 principal amount of the 0.75% Notes for each trading day of such measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable conversion rate on each such trading day;
- upon a notice of redemption by the Company; or
- upon the occurrence of specified corporate transactions.

Subsequent to December 15, 2019, Holders may convert their 0.75% Notes at the applicable conversion rate at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date.

Holders of the 0.75% Notes also have the right to require the Company to repurchase all or a portion of the 0.75% Notes at 100% of the principal amount, plus accrued and unpaid special interest, if any, upon the occurrence of certain fundamental changes to the Company.

In accordance with the authoritative accounting guidance, the Company allocated the total amount of the 0.75% Notes into liability and equity components. The carrying value of the liability component at issuance was calculated as the present value of its cash flows using a discount rate of 6.5% based on the a blended rate between the yield rate for a Moody's B1 rating and the average debt rate for comparable convertible transactions from similar companies. The difference between the 0.75% Notes principal and the carrying value of the liability component, representing the value of conversion premium assigned to the equity component, was recorded as an increase to additional paid in capital and as a debt discount on the issuance date. The equity component is being accreted using the effective interest rate method over the period from the issuance date through June 15, 2020 as a non-cash charge to interest expense. The amount recorded to additional paid in capital is not remeasured as long as it continues to meet the conditions for equity classification. Upon issuance of the 0.75% Notes, the Company recorded $174,359 as debt and $55,641 as additional paid in capital within stockholders' equity.

Additionally, the debt discount and issuance costs were bifurcated into debt issuance costs (attributable to the liability component) and equity issuance costs (attributable to the equity component) based on their relative fair values. The equity issuance costs of $1,592 were recorded as a decrease to additional paid-in capital at the issuance date.

1.25% Convertible Senior Notes due December 2018

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On December 11, 2013, the Company issued $175,000 principal amount of 1.25% Convertible Senior Notes (the "1.25% Notes," and together with the 0.75% Notes, the “Notes”) due 2018 in a private offering to qualified institutional buyers ("Holders") pursuant to Rule 144A under the Exchange Act. The initial Holders of the 1.25% Notes also had an option to purchase an additional $26,250 in principal amount which was exercised in full. The net proceeds after the agent's discount and issuance costs of $5,803 from the 1.25% Notes offering were approximately $195,446. The Company uses the net proceeds for working capital and general corporate purposes, which may include funding the Company's operations, capital expenditures, potential acquisitions of businesses, products or technologies believed to be of strategic importance. The 1.25% Notes bear interest at 1.25% per year, payable semi-annually in arrears every June 15 and December 15, beginning on June 15, 2014.

The 1.25% Notes are unsecured and rank senior in right of payment to any indebtedness expressly subordinated in right of payment to the 1.25% Notes. They rank equally with the Company's other existing and future unsecured indebtedness that is not subordinated and are structurally subordinated to any current or future secured indebtedness to the extent of the value of the assets securing the indebtedness and other liabilities of the Company's subsidiaries.

The initial conversion rate is 25.6271 shares of the Company’s common stock per $1 principal amount of notes which equates to 5,158 shares of common stock, or a conversion price equivalent of $39.02 per share of common stock. Throughout the term of the 1.25% Notes, the conversion rate may be adjusted upon the occurrence of certain events, such as the payment of cash dividends or issuance of stock warrants. The 1.25% Notes mature on December 15, 2018, unless repurchased, redeemed or converted in accordance with their terms prior to such date.

At the Company's option, on or after December 20, 2016, the Company will be able to redeem all or a portion of the 1.25% Notes at 100% of the principal amount, plus any accrued and unpaid interest, under certain conditions. The Company may redeem the 1.25% Notes in shares of the Company’s common stock, cash, or some combination of each.

Prior to June 15, 2018, the 1.25% Notes will be convertible at the option of the Holders only upon the satisfaction of certain conditions and during certain periods if any of the following events occur:

- during the calendar quarter commencing after March 31, 2014, if the last reported sale price of the Company's common stock is greater than or equal to 130% of the applicable conversion price on each such trading day for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter;
- during the 5 business day period after any 5 consecutive trading day period in which the trading price, as defined, per $1 principal amount of the 1.25% Notes for each trading day of such measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable conversion rate on each such trading day;
- upon a notice of redemption by the Company; or
- upon the occurrence of specified corporate transactions.

Subsequent to June 15, 2018, Holders may convert their 1.25% Notes at the applicable conversion rate at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date.

Holders of the 1.25% Notes also have the right to require the Company to repurchase all or a portion of the 1.25% Notes at 100% of the principal amount, plus accrued and unpaid special interest, if any, upon the occurrence of certain fundamental changes to the Company.

In accordance with the authoritative accounting guidance, the Company allocated the total amount of the 1.25% Notes into liability and equity components. The carrying value of the liability component at issuance was calculated as the present value of its cash flows using a discount rate of 6.5% based on the a blended rate between the yield rate for a Moody's B1-rating and the average debt rate for comparable convertible transactions from similar companies. The difference between the 1.25% Notes principal and the carrying value of the liability component, representing the value of conversion premium assigned to the equity component, was recorded as an increase to additional paid in capital and as a debt discount on the issuance date. The equity component is being accreted using the effective interest rate method over the period from the issuance date through December 15, 2018 as a non-cash charge to interest expense. The amount recorded to additional paid in capital is not remeasured as long as it continues to meet the conditions for equity classification. Upon issuance of the 1.25% Notes, the Company recorded $156,672 as debt and $44,578 as additional paid in capital within stockholders' equity.

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Additionally, the discount and issuance costs were bifurcated into debt issuance costs (attributable to the liability component) and equity issuance costs (attributable to the equity component) based on their relative fair values. The equity issuance costs of $1,285 were recorded as a decrease to additional paid-in capital at the issuance date.

The following table presents the carrying values of all Convertible Notes as of June 30, 2015:

	0.75% Notes	1.25% Notes	TOTAL
Liability component:			
Principal	$230,000	$201,250	$431,250
Less: debt discount and issuance costs, net of amortization	(60,231)	(35,291)	(95,522)
Net carrying amount	$169,769	$165,959	$335,728
Equity component (1)	$54,049	$43,293	$97,342

(1) Recorded in the accompanying Condensed Consolidated Balance Sheets as additional paid-in capital, net of the $2,877 issuance costs.

For the three and six months ended June 30, 2015 and 2014, the Company incurred the following interest expense related to the Notes:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Interest expense related to contractual interest coupon	$691	624	$1,320	1,253
Amortization of debt discount and issuance costs	2,696	2,173	4,962	4,316
	$3,387	$2,797	$6,282	$5,569

7. Debt

Equipment Financing Loans

The Company entered into an equipment loan agreement with Silicon Valley Bank in April 2011 for an aggregate loan principal amount of $6,000. Interest on the advances was equal to prime rate plus 0.5%. The Company had the ability to draw down on this equipment line through April 19, 2012. Each drawn amount was due 48 months after funding. The outstanding balance of equipment financing loans was fully repaid in the second quarter of 2015.

Interest expense was $1 and $23, respectively, for the three months ended June 30, 2015 and 2014, and $5 and $51, respectively, for the six months ended June 30, 2015 and 2014.

8. Common Stock

As of June 30, 2015, the Company is authorized to issue two classes of stock totaling 205,000 shares, of which 5,000 are designated as preferred stock and 200,000 are designated common stock, each with a par value of $0.0001 per share.

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

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	As of June 30, 2015	As of December 31, 2014
Shares available for future grant under the stock plans	5,560	4,330
Options outstanding under stock plans	4,620	5,288
Shares available for future issuance under ESPP	1,226	926
Common stock issuable settlement of outstanding restricted stock units	3,160	2,934
Common stock issuable upon conversion of the convertible senior notes	7,989	5,158
Total shares reserved	22,555	18,636

9. Stock Equity Plans

Stock-Based Compensation Plans

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

Stock bonus and other liability awards are accounted for as liability-classified awards, because the obligations are based predominantly on fixed monetary amounts that are generally known at the inception of the obligation, to be settled with a variable number of shares of the Company's common stock.

Under the 2002 and 2012 Plans, the term of an option grant shall not exceed ten years from the date of its grant and options generally vest over a three to four-year period, with vesting on a monthly or annual interval. Under the 2012 Plan, 20,316 shares of common stock are reserved for issuance to eligible participants. As of June 30, 2015, 5,560 shares were available for future grant. Restricted stock awards generally vest over a four-year period. The number of shares available for grant and issuance under the 2012 Plan will be increased automatically on each January 1 of 2013 through 2016 by an amount equal to 5% of the Company's shares outstanding on the immediately preceding December 31, but not to exceed 3,724 shares, unless the Board of Directors, in its discretion, determines to make a smaller increase.

Stock Options

The fair value of options granted is estimated on the grant date using the Black-Scholes option valuation model. This valuation model for stock-based compensation expense requires the Company to make assumptions and judgments about the variables used in the calculation, including the expected term (weighted-average period of time that the options granted are expected to be outstanding), the volatility of the common stock price and the assumed risk-free interest rate. The Company recognizes stock-based compensation expense for only those shares expected to vest over the requisite service period of the award. The Company determines its estimated forfeiture rate based on an analysis of its actual forfeitures and will continue to evaluate the appropriateness of the forfeiture rate based on recent forfeiture activity and expected future employee turnover, if any. Changes in the estimated forfeiture rate can have a significant effect on reported stock-based compensation expense, as the cumulative effect of adjusting the rate for all expense is recognized in the period the forfeiture estimate is changed. No compensation cost is recorded for options that do not vest and the compensation cost from vested options, whether forfeited or not, is not reversed.

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The weighted average fair value of stock options granted to employees was $28.23 and $19.51 during the three months ended June 30, 2015 and 2014, respectively, and $27.81 and $19.88 during the six months ended June 30, 2015 and 2014, respectively. The fair values were estimated on the grant dates using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Expected life (in years)	5.31 - 6.08	5.31 - 6.08	5.31 - 6.08	5.31 - 6.08
Volatility	50 %	54% - 58%	50% - 52%	54% - 58%
Risk-free interest rate	1.7 %	1.8% - 1.9%	1.6% - 1.7%	1.8% - 1.9%
Dividend yield	— %	— %	— %	— %

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

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

Stock option activity under the Plan is as follows:

	Shares subject to Options Outstanding			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balance at December 31, 2014	5,288	$11.06	6.31	$196,608
Options granted	259	56.68		
Options exercised	(843)	7.73		
Options forfeited and canceled	(84)	19.36		
Balance at June 30, 2015	4,620	$14.08	6.11	$229,116

The total intrinsic value of options exercised was $40,237 and $32,192 for the six months ended June 30, 2015 and 2014, respectively. Total cash proceeds from such option exercises were $6,520 and $6,465 for the six months ended June 30, 2015 and 2014, respectively.

The fair value of option grants that vested was $5,896 and $5,870 for the six months ended June 30, 2015 and 2014, respectively.

As of June 30, 2015, the Company had unamortized stock-based compensation expense of $16,654 related to stock options, that will be recognized net of forfeitures over the average remaining vesting term of the options of 2.14 years.

Restricted Stock and Performance Stock Units

A following table summarized the activity of RSUs and PSUs:

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	RSUs and PSUs Outstanding	
	Number of Shares	Granted Fair Value Per Unit
Awarded and unvested at December 31, 2014	2,934	$37.45
Awards granted	801	57.37
Awards vested	(459)	35.64
Awards forfeited	(116)	34.82
Awarded and unvested at June 30, 2015	3,160	$42.87

As of June 30, 2015, there was $82,846 of unamortized stock-based compensation expense related to unvested RSUs, which is expected to be recognized over a weighted average period of 3.27 years.

The Company granted 172 and 17 PSUs in the six months ended June 30, 2015 and 2014, respectively. The PSU vesting conditions were based on individual performance targets. Unamortized expense was $4,046 as of June 30, 2015, net of estimated forfeitures.

Stock Bonus and Other Liability Awards

The total accrued liability for the stock bonus awards was $1,459 and $1,771 as of June 30, 2015 and December 31, 2014, respectively. 27 and 22 shares of common stock earned under the stock bonus program were issued during the six months ended June 30, 2015 and 2014, respectively. Stock based compensation expense related to stock bonus program were $1,459 and $988 for the six months ended June 30, 2015 and 2014, respectively.

In March 2015, the Company issued liability awards with a fair value of $6,885, which vest over three years period and are subject to continuous service and other conditions. The liability awards will be settled with a variable number of shares of the Company's common stock. The Company recognized $729 of stock-based compensation expense related to these liability awards in the six months ended June 30, 2015.

Employee Stock Purchase Plan

On March 30, 2012, the Board of Directors and the Company’s stockholders approved the 2012 Employee Stock Purchase Plan (the "ESPP"), which became effective in April 2012. A total of 745 shares of the Company's common stock were initially reserved for future issuance under the ESPP. The number of shares reserved for issuance under the ESPP will increase automatically on January 1 of each of the first eight years commencing with 2013 by the number of shares equal to 1% of the Company's shares outstanding on the immediately preceding December 31, but not to exceed 1,490 shares, unless the Board of Directors, in its discretion, determines to make a smaller increase. As of June 30, 2015, there were 1,226 shares of the Company's common stock available for future issuance under the ESPP. As of June 30, 2015, the Company expects to recognize $882 of the total unamortized compensation cost related to employee purchases under the ESPP over a weighted average period of 0.38 years.

Restricted Stock

The Company granted 54 shares of restricted stock in the fourth quarter of 2014 to certain key employees with the total fair value of $2,357 and two-year cliff vesting in 2016. The Company recognized $589 of stock based compensation expense in the six months ended June 30, 2015, and as of June 30, 2015, there was $1,572 of unamortized stock-based compensation expense related to the unvested shares of restricted stock. The shares of restricted stock are subject to forfeiture if employment terminates prior to the lapse of the restrictions, and are expensed over the vesting period. They are considered issued and outstanding shares of the Company at the grant date and have the same rights as other shares of common stock.

10. Net Loss per Share

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

	As of June 30,	
	2015	2014
Stock options to purchase common stock	4,620	6,482
Restricted stock units	3,160	2,236
Employee stock purchase plan	78	106
Common stock subject to repurchase	54	—
Bonus and other liability awards	158	—
1.25% Convertible senior notes	5,158	5,158
0.75% Convertible senior notes	2,831	—
Total	16,059	13,982

11. Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting supported and defined by the components of an enterprise about which separate financial information is available, provided and is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is its Chief Executive Officer. The Company's Chief Executive Officer reviews financial information presented on a consolidated basis. We have one business activity, and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Accordingly, we have determined that we have one operating and reportable segment.

The following set forth total revenue by solutions offered by the Company and geographic area. Revenue by geographic area is based upon the billing address of the customer:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Total revenue by solution:				
Privacy, Protection and Security	$50,431	$35,549	$95,802	$68,152
Archiving and Governance	13,115	10,849	25,507	20,950
Total revenue	$63,546	$46,398	$121,309	$89,102

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Total revenue:				
United States	$52,701	$38,012	$99,755	$73,229
Rest of world	10,845	8,386	21,554	15,873
Total revenue	$63,546	$46,398	$121,309	$89,102

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Long-lived assets by geographic area are presented below:

	As of June 30, 2015	As of December 31, 2014
Long-lived assets:		
United States	$23,314	$15,974
Rest of world	3,460	2,744
Total long lived assets	$26,774	$18,718

12. Income Taxes
The Company’s quarterly provision for income taxes is based on an estimated effective annual income tax rate. The Company’s quarterly provision for income taxes also includes the tax impact of certain unusual or infrequently occurring items, if any, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, in the interim period in which they occur.

Income tax expense for the three and six months ended June 30, 2015 was $112 and $274 on pre-tax losses of $24,861 and $46,372, respectively. The Company recognized income tax expense of $147 and $291 for the three and six months ended June 30, 2014 on pre-tax losses of $14,978 and $29,229, respectively. The income tax rate for the three and six months ended June 30, 2015 and 2014 varies from the United States statutory income tax rate primarily due to valuation allowances in the United States whereby pre-tax losses and gains do not result in the recognition of corresponding income tax benefits and expenses.

The Company's effective tax rate for the six months ended June 30, 2015 decreased to negative 0.6% from negative 1.0% for the same prior year period.

The Company reviews the likelihood that it will realize the benefit of its deferred tax assets and, therefore, the need for valuation allowances, on a quarterly basis. There is no corresponding income tax benefit recognized with respect to losses incurred and no corresponding income tax expense recognized with respect to earnings generated in jurisdictions with a valuation allowance. This causes variability in the Company’s effective tax rate. The Company intends to maintain the valuation allowances until it is more likely than not that the net deferred tax assets will be realized.

As of June 30, 2015, the Company's gross uncertain tax benefits totaled $4,268, excluding related accrued interest and penalties of $234. As of June 30, 2015, $1,306 of the Company's uncertain tax benefits, including related accrued interest and penalties, would affect the effective tax rate if recognized. During the six months ended June 30, 2015, the Company's gross uncertain tax benefits increased $42. The increase is comprised of $79 increase for tax positions taken in the current period offset by an $18 increase for tax positions taken in prior periods and a $55 decrease related to statute of limitation expirations.

The Company is not currently under audit by the IRS or any similar taxing authority in any other material jurisdiction. The Company believes it has recorded all appropriate provisions for all jurisdictions and open years. However, the Company can give no assurance that taxing authorities will not propose adjustments that would increase its tax liabilities.

13. Subsequent events
In July 2015, the Company acquired certain assets of Marble Security, Inc. (“Marble”) for a purchase price of $8,500. The Marble mobile security technology proactively removes malicious mobile applications by leveraging its tight

integration with the leading enterprise mobility management (EMM) platforms, including MobileIron and AirWatch by VMware. The acquisition extends the Company's proven threat intelligence and advanced threat protection for email and social media security into the realm of mobile devices. Management is currently in the process of valuing the assets acquired and liabilities assumed associated with this asset purchase.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the (1) unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q, and (2) the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2014 included in our Annual Report on Form 10-K, or 2014 Annual Report on Form 10-K. This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements are often identified by the use of words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and similar expres variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled "Risk Factors", set forth in Part II, Item 1A of this Form 10-Q and in our other SEC filings, including our 2014 Annual Report on Form 10-K. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

Proofpoint is a leading security-as-a-service ("SaaS") provider that enables large and mid-sized organizations worldwide to defend, protect, archive and govern their most sensitive data. Our SaaS platform is comprised of an integrated suite of on-demand data protection solutions, including threat management and incident response, regulatory compliance, archiving, data governance and eDiscovery, and secure communication. Our solutions are built on a flexible, cloud-based platform and leverage a number of proprietary technologies, including big data analytics, machine learning, deep content inspection, secure storage, advanced encryption, intelligent message routing, dynamic malware analysis, threat correlation, and virtual execution environments, to address today's rapidly changing threat landscape.

Our platform addresses this growing challenge by not only protecting data as it flows into and out of the enterprise via on-premise and cloud-based email, instant messaging, social media and other web-based applications, but also by keeping track of such information as it is modified and distributed throughout the enterprise for compliance and data loss prevention and securely archiving these communications for compliance and discovery. We address four important problems for the enterprise:

- keeping malicious content out of the extended enterprise;
- preventing the theft or inadvertent loss of sensitive information and, in turn, ensuring compliance with regulatory data protection mandates;
- collecting, retaining, governing and discovering sensitive data for compliance and litigation support; and
- securely sharing sensitive data with customers, partners and suppliers.

Our platform and its associated solutions are sold to customers on a subscription basis and can be deployed through our unique cloud-based architecture that leverages both our global data centers as well as optional points-of-presence behind our customers' firewalls. Our flexible deployment model enables us to deliver superior security and compliance while maintaining the favorable economics afforded by cloud computing, creating a competitive advantage for us over legacy on-premise and cloud-only offerings.

We were founded in 2002 to provide a unified solution to help enterprises address their growing data security requirements. Our first solution was commercially released in 2003 to combat the burgeoning problem of spam and viruses and their impact on corporate email systems. To address the evolving threat landscape and the adoption of communication and collaboration systems beyond corporate email and networks, we have broadened our solutions to defend against a wide range of threats, protect against outbound security risks, and archive and govern corporate information. As the threat environment has continued to evolve, we have dedicated significant resources to meet the ongoing challenges that this highly dynamic environment creates for our customers such as investing significantly to expand the breadth of our data protection platform as these expenditures are primarily in connection with the replacement and upgrade of equipment to lower the cost of deployment as well as to improve the efficiency for our cloud-based architecture.

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Our business is based on a recurring revenue model. Our customers pay a subscription fee to license the various components of our SaaS platform for a contract term that is typically one to three years. At the end of the license term, customers may renew their subscription and in each year since the launch of our first solution in 2003, we have retained over 90% of our customers. We derive this retention rate by calculating the total annually recurring subscription revenue from customers currently using our SaaS platform and dividing it by the total annually recurring subscription revenue from both these current customers as well as all business lost through non-renewal. A growing number of our customers increase their annual subscription fees after their initial purchase by broadening their use of our platform or by adding more users, and these sales have consistently represented 15% or more of our billings each year since 2008.

We market and sell our solutions worldwide both directly through our sales teams and indirectly through a hybrid model where our sales organization actively assists our network of distributors and resellers. We also derive a lesser portion of our total revenue from the license of our solutions to strategic partners who offer our solutions in conjunction with one or more of their own products or services.

Our solutions are designed to be implemented, configured and operated without the need for any training or professional services. For those customers that seek to develop deeper expertise in the use of our solutions or would like assistance with complex configurations or the importing of data, we offer various training and professional services. In some cases, we provide a hardware appliance to those customers that elect to host elements of our solution behind their firewall. Increasing adoption of virtualization in the data center has led to a decline in the sales of our hardware appliances and a shift towards our software-based virtual appliances, which are delivered as a download via the Internet. Our hardware and services offerings carry lower margins and are provided as a courtesy to our customers. We expect the overall proportion of revenue derived from the hardware and services offerings to generally remain below 10% of our total revenue.

Historically, the majority of our revenue was derived from our customers in the United States. We believe the markets outside of the United States offer an opportunity for growth and we intend to make additional investments in sales and marketing to expand in these markets. Revenue from customers outside of the United States grew 29% for the three months ended June 30, 2015 as compared to the prior year period. As of June 30, 2015, we had approximately 3,400 customers around the world, including 56 of the Fortune 100. In terms of customer concentration, one partner accounted for 11% of our total revenue for the three months ended June 30, 2015 and for 12% of our total revenue for the three months ended June 30, 2014, although the partner sold to a number of end-user customers, none which accounted for more than 10% of our total revenue. Other than the aforementioned partner above, there were no other single partners or customers that accounted for more than 10% of our total revenue in the three months ended June 30, 2015.

We have not been profitable to date and will need to grow revenue at a rate faster than our investments in cost of revenue and operating expenses in order to achieve profitability, as discussed in more detail below.

Key Opportunities and Challenges

The majority of costs associated with generating customer agreements are incurred up front. These upfront costs include direct incremental sales commissions, which are recognized upon the billing of the contract. The costs associated with the teams tasked with closing business with new customers and additional business with our existing customers have represented more than 90% of our total sales and marketing costs since 2008. Although we expect customers to be profitable over the duration of the customer relationship, these upfront costs typically exceed related revenue during the earlier periods of a contract. As a result, while our practice of invoicing our customers for the entire amount of the contract at the start of the term provides us with a relatively immediate contribution to cash flow, the revenue is recognized ratably over the term of the contract, and hence contributions toward operating income are limited in the period where these sales and marketing costs are incurred. Accordingly, an increase in the mix of new customers as a percentage of total customers would likely negatively impact our near-term operating results. On the other hand, we expect that an increase in the mix of existing customers as a percentage of total customers would positively impact our operating results over time. As we accumulate customers that continue to renew their contracts, we anticipate that our mix of existing customers will increase, contributing to a decrease in our sales and marketing costs as a percentage of total revenue and a commensurate improvement in our operating income.

As part of maintaining our SaaS platform, we provide ongoing updates and enhancements to the platform services both in terms of the software as well as the underlying hardware and data center infrastructure. These updates and enhancements are provided to our customers at no additional charge as part of the subscription fees paid for the use of our platform. While more traditional products eventually become obsolete and require replacement, we are constantly updating and maintaining our cloud-based services and as such they operate with a continuous product life cycle. Much of this work is designed to both maintain and enhance the customers' experiences over time while also lowering our costs to deliver the

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service. Our SaaS platform is a shared infrastructure that is used by all of our customers. Accordingly, the costs of the platform are spread in a relatively uniform manner across the entire customer base and no specific infrastructure elements are directly attached to any particular customer. As such, in the event that a customer chooses to not renew its subscription, the underlying resources are reallocated either to new customers or to accommodate the expanding needs of our existing customers and, as a result, we do not believe that the loss of any particular customer has a meaningful impact on our gross profit as long as we continue to grow our customer base.

To date, our customers have primarily used our solutions in conjunction with email messaging content. We have developed solutions to address the new and evolving messaging solutions such as social media and file sharing applications, but these solutions are relatively nascent. If customers increase their use of these new messaging solutions in the future, we anticipate that our growth in revenue associated with older email messaging solutions may slow over time. Although revenue associated with our social media and file sharing applications has not been material to date, we believe that our ability to provide security, archiving, governance and discovery for these new solutions will be viewed as valuable by our existing customers, enabling us to derive revenue from these new forms of messaging and communication.

While the majority of our current and prospective customers run their email systems on premise, we believe that there is a trend for large and mid-sized enterprises to migrate these systems to the cloud. While our current revenue derived from customers using cloud-based email systems continues to grow as a percentage of our total revenue, many of these cloud-based email solutions offer some form of threat protection and governance services, potentially mitigating the need for customers to buy these capabilities from third parties such as ourselves. We believe that we can continue to provide security, archiving, governance, and discovery solutions that are differentiated from the services offered by cloud-based email providers, and as such our platform will continue to be viewed as valuable to enterprises once they have migrated their email services to the cloud, enabling us to continue to derive revenue from this new trend toward cloud-based email deployment models.

With the majority of our business, we invoice our customers for the entire contract amount at the start of the term and these amounts are recorded as deferred revenue on our balance sheet, with the dollar weighted average duration of these contracts for any given period over the past three years typically ranging from 16 to 22 months. As a result, while our practice of invoicing customers for the entire amount of the contract at the start of the term provides us with a relatively immediate contribution to cash flow, the revenue is recognized ratably over the term of the contract, and hence contributions toward operating income are realized over an extended period. As such, our efforts to improve our profitability require us to invest far less in operating expenses than the cash flow generated by our business might otherwise allow. As we strive to invest in an effort to continue to increase the size and scale of our business, we expect that the level of investment afforded by our growth in revenue should be sufficient to fund the investments needed to drive revenue growth and broaden our product line.

Considering all of these factors, we do not expect to be profitable on a GAAP basis in the near term and in order to achieve profitability we will need to grow revenue at a rate faster than our investments in operating expenses and cost of revenue.

We intend to grow our revenue through acquiring new customers by investing in our sales and marketing activities. We believe that an increase in new customers in the near term will result in a larger base of renewal customers, which, over time, we expect to be more profitable for us.

Sales and marketing is our greatest expense and hence a significant contributing factor to our operating losses. Given that our costs to acquire new revenue sources, either in the form of new customers or the sale of additional solutions to existing customers, often exceed the actual revenue recognized in the initial periods, we believe that our opportunity to improve our return on investment on sales and marketing costs relies primarily on our ongoing ability to cost-effectively renew our business with existing customers, thereby lowering our overall sales and marketing costs as a percentage of revenue as the mix of revenue derived from this more profitable renewal activity increases over time. Therefore, we anticipate that our initial significant investments in sales and marketing activities will, over time, generate a larger base of more profitable customers. Cost of subscription revenue is also a significant expense for us, and we expect to continue to build on the improvements over the past years, such as in replacing third-party technology with our proprietary technology and improving the utilization of our fixed investments in equipment and infrastructure, in order to provide the opportunity for improved subscription gross margins over time. Although we plan to continue enhancing our solutions, we intend to lower our rate of investment in research and development as a percentage of revenue over time by deriving additional revenue from our existing platform of solutions rather than by adding entirely new categories of solutions. In addition, as personnel costs are one of the primary drivers of the increases in our operating expenses, we plan to reduce our historical rate of headcount growth over time.

Key Metrics

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We regularly review a number of metrics, including the following key metrics presented in the table below, to evaluate our business, measure our performance, identify trends in our business, prepare financial projections and make strategic decisions. Many of these key metrics, such as adjusted subscription gross profit, billings and adjusted EBITDA, are non-GAAP measures. This non-GAAP information is not necessarily comparable to non-GAAP information of other companies. Non-GAAP information should not be viewed as a substitute for, or superior to, net loss prepared in accordance with GAAP as a measure of our profitability or liquidity. Users of this financial information should consider the types of events and transactions for which adjustments have been made.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015		2014		2015		2014	
	(in thousands)				(in thousands)			
Total revenue	$63,546		$46,398		$121,309		$89,102	
Growth	37	%	46	%	36	%	42	%
Subscription revenue	$61,778		$45,047		$117,634		$86,251	
Growth	37	%	46	%	36	%	46	%
Adjusted subscription gross profit	$47,686		$33,988		$89,703		$64,982	
% of subscription revenue	77	%	75	%	76	%	75	%
Billings	$75,521		$50,068		$141,875		$96,682	
Growth	51	%	43	%	47	%	38	%
Adjusted EBITDA	$458		$120		$1,650		$(1,250	)

Subscription revenue

Subscription revenue represents the recurring subscription fees paid by our customers and recognized as revenue during the period for the use of our security-as-a-service platform, typically licensed for one to three years at a time. We consider subscription revenue to be a key business metric because it reflects the recurring aspect of our business model and is the primary driver of growth for our business over time. The consistent growth in subscription revenue over the past several years has resulted from our ongoing investment in sales and marketing personnel, our efforts to expand our customer base, and our efforts to broaden the use of our platform with existing customers.

Adjusted subscription gross profit

We have included adjusted subscription gross profit, a non GAAP financial measure, in this report because it is a key measure used by our management and board of directors to understand and evaluate our operating results, core operating performance, and trends to prepare and approve our annual budget and to develop short and long-term operational plans. We have provided a reconciliation between subscription gross profit, the most directly comparable GAAP financial measure, and adjusted subscription gross profit. We believe that adjusted subscription gross profit provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

Our use of adjusted subscription gross profit has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Because of these limitations, you should consider adjusted subscription gross profit alongside other financial performance measures, including subscription gross profit and our other GAAP results.

The following table presents the reconciliation of subscription gross profit to adjusted subscription gross profit for the three and six months ended June 30, 2015 and 2014:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Subscription revenue	$61,778	$45,047	$117,634	$86,251
Cost of subscription revenue	16,829	12,544	33,163	23,995
Subscription gross profit	44,949	32,503	84,471	62,256
Stock based compensation	1,148	511	2,263	923
Amortization of intangible assets	1,589	974	2,969	1,803
Adjusted subscription gross profit	$47,686	$33,988	$89,703	$64,982

Billings

We have included billings, a non GAAP financial measure, in this report because it is a key measure used by our management and board of directors to manage our business and monitor our near term cash flows. We have provided a reconciliation between total revenue, the most directly comparable GAAP financial measure, and billings. Accordingly, we believe that billings provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

Our use of billings as a non-GAAP measure has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for revenue or an analysis of our results as reported under GAAP. Some of these limitations are:

- Billings is not a substitute for revenue, as trends in billings are not necessarily directly correlated to trends in revenue;
- Billings is affected by a combination of factors including the timing of renewals, the sales of our solutions to both new and existing customers, the relative duration of contracts sold, and the relative amount of business derived from strategic partners. As each of these elements has unique characteristics in the relationship between billings and revenue, our billings activity is not necessarily closely correlated to revenue; and
- Other companies, including companies in our industry, may not use billings, may calculate billings differently, or may use other financial measures to evaluate their performance all of which reduce the usefulness of billings as a comparative measure.

The following table presents the reconciliation of total revenue to billings for the three and six months ended June 30, 2015 and 2014:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Total revenue	$63,546	$46,398	$121,309	$89,102
Deferred revenue				
Ending	183,941	131,563	183,941	131,563
Beginning	171,966	127,893	162,675	123,983
Net change	11,975	3,670	21,266	7,580
Less: deferred revenue contributed by acquisitions	—	—	(700)	—
Billings	$75,521	$50,068	$141,875	$96,682

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Adjusted EBITDA

We define adjusted EBITDA as net loss, adjusted to exclude: depreciation, amortization of intangibles, interest (income) expense, net, provision for (benefit from) income taxes, stock based compensation, acquisition- and litigation-related expenses, other (income) expense, net. We believe that adjusted EBITDA is useful to investors and other users of our financial statements in evaluating our operating performance because it provides them with an additional tool to compare business performance across companies and across periods. We believe that:

- Adjusted EBITDA provides investors and other users of our financial information consistency and comparability with our past financial performance, facilitates period-to-period comparisons of operations and facilitates comparisons with our peer companies, many of which use similar non-GAAP financial measures to supplement their GAAP results; and
- It is useful to exclude certain non-cash charges, such as depreciation, amortization of intangible assets and stock based compensation and non-core operational charges, such as acquisition- and litigation-related expenses, from adjusted EBITDA because the amount of such expenses in any specific period may not be directly correlated to the underlying performance of our business operations and these expenses can vary significantly between periods as a result of new acquisitions, full amortization of previously acquired tangible and intangible assets or the timing of new stock based awards, as the case may be.

We use adjusted EBITDA in conjunction with traditional GAAP operating performance measures as part of our overall assessment of our performance, for planning purposes, including the preparation of our annual operating budget, to evaluate the effectiveness of our business strategies and to communicate with our board of directors concerning our financial performance.

We do not place undue reliance on adjusted EBITDA as our only measure of operating performance. Adjusted EBITDA should not be considered as a substitute for other measures of financial performance reported in accordance with GAAP. There are limitations to using non-GAAP financial measures, including that other companies may calculate these measures differently than we do, that they do not reflect our capital expenditures or future requirements for capital expenditures and that they do not reflect changes in, or cash requirements for, our working capital.

The following table presents the reconciliation of net loss to adjusted EBITDA for the three and six months ended June 30, 2015 and 2014:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Net loss	$(24,973)	$(15,125)	$(46,646)	$(29,520)
Depreciation	3,046	2,194	5,803	4,036
Amortization of intangible assets	2,917	2,109	5,624	4,069
Interest expense	3,332	2,798	6,185	5,571
Provision for income taxes	112	147	274	291
EBITDA	(15,566)	(7,877)	(28,760)	(15,553)
Stock-based compensation expense	15,235	7,328	27,661	13,301
Acquisition-related expense	114	346	361	358
Litigation-related expense	595	330	1,128	452
Other expense (income), net	80	(7)	1,260	192
Adjusted EBITDA	$458	$120	$1,650	$(1,250)

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our accompanying Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates, assumptions and judgments that can have significant impact on the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. We base our estimates, assumptions and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. On a regular basis we evaluate our estimates, assumptions and judgments and make changes accordingly.

We believe that the estimates, assumptions and judgments involved in revenue recognition, stock-based compensation expense, fair value of assets acquired and liabilities assumed in business combinations, impairment assessment of goodwill, intangible assets and other long-lived assets, loss contingency, and recognition and measurement of current and deferred income taxes have the greatest potential impact on our accompanying Condensed Consolidated Financial Statements, and consider these to be our critical accounting estimates. Historically, our estimates, assumptions and judgments relative to our critical accounting policies have not differed materially from actual results. The critical accounting estimates associated with these policies are described in our 2014 Annual Report on Form 10-K, under "Management's Discussion and Analysis of Financial Condition and Results of Operations." There have been no material changes to our significant accounting policies as compared to the significant accounting policies described in our 2014 Annual Report on Form 10-K for the year ended December 31, 2014.

Components of Our Results of Operations

Business Combinations

In each of our acquisitions, we used the purchase method of accounting which requires us to allocate the fair value of the total consideration transferred to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values on the date of the acquisition, with the difference between the net assets acquired and the total consideration transferred recorded as goodwill. The fair values assigned, defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants, are based on significant estimates and assumptions determined by management. These estimates and assumptions are inherently uncertain and subject to refinement, as a result, during the adjustment period, which may be up to one year from the acquisition date, we may record adjustments to the assets acquired or liabilities assumed with any corresponding offset to goodwill. Upon conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to our accompanying condensed consolidated statements of operations.

We used either the discounted cash flow method or the replacement cost method to assign fair values to acquired identifiable intangible assets. This method requires significant management judgment to forecast future operating results and establish residual growth rates and discount factors. These models are based on reasonable estimates and assumptions given available facts and circumstances, including industry estimates and averages, as of the acquisition dates and are consistent with the plans and estimates that we use to manage our business. If the subsequent actual results and updated projections of the underlying business activity change compared with the estimates and assumptions used to develop these values, we could experience impairment charges. In addition, we have estimated the economic lives of certain acquired assets and these lives are used to calculate depreciation and amortization expense. If our estimates of the economic lives change, depreciation or amortization expenses could be accelerated or slowed.

Revenue

We derive our revenue primarily through the license of various solutions and services on our security-as-a-service platform on a subscription basis, supplemented by the sales of training, professional services and hardware depending upon our customers' requirements.

Subscription. We license our platform and its associated solutions and services on a subscription basis. The fees are charged on a per user, per year basis. Subscriptions are typically one to three years in duration. We invoice our customers upon signing for the entire term of the contract. The invoiced amounts billed in advance are treated as deferred revenue on the balance sheet and are recognized ratably, in accordance with the appropriate revenue recognition guidelines, over the term of the contract. We also derive a portion of our subscription revenue from the license of our solutions to strategic partners. We bill these strategic partners monthly. We expect our subscription revenue will continue to grow and remain above 90% of our total revenue.

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Hardware and services. We provide hardware appliances as a convenience to our customers and as such it represents a small part of our business. Our solutions are designed to be implemented, configured and operated without the need for any training or professional services. For those customers that seek to develop deeper expertise in the use of our solutions or would like assistance with complex configurations or the importing of data, we offer various training and professional services. We typically invoice the customer for hardware at the time of shipment. We typically invoice customers for services at the time the order is placed and recognize this revenue ratably over the term of the contract. On occasion, customers may retain us for special projects such as archiving import and export services; these types of services are recognized upon completion of the project. We expect the overall proportion of revenue derived from hardware and service offerings to generally remain below 10% of our total revenue.

Total Cost of Revenue

Our cost of revenues consists of cost of subscription revenue and cost of hardware and services revenue. Personnel costs, which consist of salaries, benefits, bonuses, and stock based compensation, data center costs and hardware costs are the most significant components of our cost of revenues. We expect personnel costs to continue to increase in absolute dollars as we hire new employees to continue to grow our business.

Cost of Subscription Revenue. Cost of subscription revenue primarily includes personnel costs, consisting of salaries, benefits, bonuses, and stock based compensation, for employees who provide support services to our customers and operate our data centers. Other costs include fees paid to contractors who supplement our support and data center personnel; expenses related to the use of third party data centers in both the United States and internationally; depreciation of data center equipment; amortization of licensing fees and royalties paid for the use of third party technology; amortization of internally developed intangible assets; and the amortization of intangible assets acquired through business combinations. Growth in subscription revenue generally consumes production resources, requiring us to gradually increase our cost of subscription revenue in absolute dollars as we expand our investment in data center equipment, the third-party data center space required to house this equipment, and the personnel needed to manage this higher level of activity.

Cost of Hardware and Services Revenue. Cost of hardware and services revenue includes personnel costs for employees who provide training and professional services to our customers as well as the cost of server hardware shipped to our customers that we procure from third parties and configure with our software solutions.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing, and general and administrative expenses. Personnel costs, which consist of salaries, benefits, bonuses, and stock based compensation, are the most significant component of our operating expenses. We expect personnel costs to continue to increase in absolute dollars as we hire new employees to continue to grow our business. Our headcount has increased 26% from December 31, 2013 to December 31, 2014. As a result of this growth in headcount, operating expenses have increased significantly over these periods. We expect personnel costs to continue to increase in absolute dollars as we hire new employees to continue to grow our business.

Research and Development. Research and development expenses include personnel costs, consulting services and depreciation. We believe that these investments have played an important role in broadening the capabilities of our platform over the course of our operating history, enhancing the relevance of our solutions in the market in general and helping us to retain our customers over time. We expect to continue to devote substantial resources to research and development in an effort to continuously improve our existing solutions as well as to develop new offerings. We believe that these investments are necessary to maintain and improve our competitive position, however, over the longer term, we intend to monitor these costs so as to decrease this spending as a percentage of total revenue. Our research efforts include both software developed for our internal use on behalf of our customers as well as software elements to be used by our customers in their own facilities. To date, our capitalized costs on software developed for internal use on behalf of our customers were not material. For the software developed for use on our customers' premises, the costs associated with the development work between technological feasibility and the general availability has not been material and as such we have not capitalized any of these development costs to date.

Sales and Marketing. Sales and marketing expenses include personnel costs, sales commissions, and other costs including travel and entertainment, marketing and promotional events, public relations and marketing activities. All of these costs are expensed as incurred. These costs also include amortization of intangible assets as a result of our past acquisitions. Due to our continued investment in growing our sales and marketing operations, both domestically and internationally, headcount increases were reflected in higher compensation expense consistent with our revenue growth. Our sales personnel are typically not immediately productive,

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and therefore the increase in sales and marketing expenses we incur when we add new sales representatives is not immediately offset by increased revenue and may not result in increased revenue over the long-term if these new sales people fail to become productive. The timing of our hiring of new sales personnel and the rate at which they generate incremental revenue will affect our future financial performance. We expect that sales and marketing expenses will continue to increase in absolute dollars and be among the most significant components of our operating expenses.

General and Administrative. General and administrative expenses consist of personnel costs, consulting services, audit fees, tax services, legal expenses and other general corporate items. As a result of our operational growth, we expect our general and administrative expenses to increase in absolute dollars in future periods as we continue to expand our operations and hire additional personnel.

Total Other Income (Expense), Net

Total other income (expense), net, consists of interest income (expense), net and other income (expense), net. Interest income (expense), net, consists primarily of interest income earned on our cash, cash equivalents and short-term investments offset by the interest expense related to our convertible senior notes, our capital lease payments and borrowings under our equipment loans. Other income (expense), net, consists primarily of the net effect of foreign currency transaction gains and losses.

(Provision for) Benefit from Income Taxes

The (provision for) benefit from income taxes is related to certain state and foreign income taxes. As we have incurred operating losses in all periods to date and recorded a full valuation allowance against our deferred tax assets, we have not historically recorded a provision for federal income taxes, except a $0.8 million deferred tax benefit related to the release of U.S. valuation allowance as a result of the Nexgate acquisition in the fourth quarter of 2014 and the recognition of a $0.1 million deferred tax expense in the six months ended June 30, 2015 related to goodwill in excess of tax deductible goodwill for recent taxable transactions. Realization of any of our deferred tax assets depends upon future earnings, the timing and amount of which are uncertain. Utilization of our net operating losses may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Analyses have been conducted to determine whether an ownership change had occurred since inception. The analyses have indicated that although ownership changes have occurred in prior years, the net operating losses and research and development credits would not expire before utilization as a result of the ownership change. In the event we have subsequent changes in ownership, net operating losses and research and development credit carryovers could be limited and may expire unutilized as a result of the subsequent ownership change.

Results of Operations

The following table is a summary of our consolidated statements of operations and results of operations as a percentage of our total revenue for those periods.

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	Three Months Ended June 30, 2015		2014		Six Months Ended June 30, 2015		2014	
	Amount	% of revenue	Amount	% of revenue	Amount	% of revenue	Amount	% of revenue
	($ in thousands)				($ in thousands)			
Revenue:								
Subscription	$61,778	97 %	$45,047	97 %	$117,634	97 %	$86,251	97 %
Hardware and services	1,768	3	1,351	3	3,675	3	2,851	3
Total revenue	63,546	100	46,398	100	121,309	100	89,102	100
Cost of revenue:								
Subscription	16,829	26	12,544	27	33,163	27	23,995	27
Hardware and services	2,995	5	2,717	6	5,949	5	4,977	6
Total cost of revenue	19,824	31	15,261	33	39,112	32	28,972	33
Gross profit	43,722	69	31,137	67	82,197	68	60,130	67
Operating expense:								
Research and development	18,659	30	12,298	27	34,367	28	24,246	27
Sales and marketing	38,017	60	24,180	52	70,929	58	46,998	53
General and administrative	8,495	13	6,846	15	15,828	13	12,352	14
Total operating expense	65,171	103	43,324	94	121,124	99	83,596	94
Operating loss	(21,449)	(34)	(12,187)	(27)	(38,927)	(31)	(23,466)	(27)
Interest expense	(3,332)	(5)	(2,798)	(6)	(6,185)	(5)	(5,571)	(6)
Other income (expense), net	(80)	—	7	—	(1,260)	(1)	(192)	—
Loss before provision for income taxes	(24,861)	(39)	(14,978)	(33)	(46,372)	(37)	(29,229)	(33)
Provision for income taxes	(112)	—	(147)	—	(274)	(1)	(291)	—
Net loss	$(24,973)	(39)%	$(15,125)	(33)%	$(46,646)	(38)%	$(29,520)	(33)%

Comparison of the three and six months ended June 30, 2015 and 2014:

Revenue

	Three Months Ended June 30, 2015	2014	% Change	Six Months Ended June 30, 2015	2014	% Change
	(in thousands)			(in thousands)		
Revenue						
Subscription	$61,778	$45,047	37 %	$117,634	$86,251	36 %
Hardware and services	1,768	1,351	31	3,675	2,851	29
Total revenue	$63,546	$46,398	37 %	$121,309	$89,102	36 %

Subscription revenue for the three and six months ended June 30, 2015 increased $16.7 million, or 37%, and $31.4 million, or 36%, as compared to the corresponding periods last year. These increases were primarily due to a $14.5 million and $26.0 million increase in subscription revenue contributed from the United States, respectively. To a lesser extent, for the same periods, there were increases of $2.2 million and $5.4 million in revenue contributed from international locations, respectively. The businesses acquired contributed to the increases of $1.4 million and $2.1 million for the three and six months periods ended June 30, 2015, respectively. The remaining increases were due to improved demand for our platform worldwide due to a shift in

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the overall threat landscape, the growth of business-to-business collaboration as well as the consumerization of IT which led to the increase in demand for data protection and governance solutions.

Hardware and services revenue for the three and six months ended June 30, 2015 increased $0.4 million, or 31%, and $0.8 million, or 29%, as compared to the corresponding periods last year primarily due to higher revenue from professional services due to increased demand.

Cost of Revenue

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	% Change	2015	2014	% Change
	(in thousands)			(in thousands)		
Cost of revenue						
Subscription	$16,829	$12,544	34 %	$33,163	$23,995	38 %
Hardware and services	2,995	2,717	10	5,949	4,977	20
Total cost of revenue	$19,824	$15,261	30 %	$39,112	$28,972	35 %

Cost of subscription revenue for the three and six months ended June 30, 2015 increased $4.3 million, or 34%, and $9.2 million, or 38%, respectively, as compared to the corresponding periods last year. The increase was primarily due to an increase in operations-related expense of $2.9 million and $6.0 million, respectively, as a result of increased headcount, depreciation expense as a result of higher capital expenditures to support our growth, and intangible amortization expense of developed technology from the acquisitions. Additionally, support-related expenses increased $1.2 million and $2.5 million, respectively, primarily due to higher headcount and consulting costs. Data center costs increased $0.3 million and $0.6 million, respectively, primarily due to subscription revenue growth in our cloud-based solutions.

Cost of hardware and services revenue for the three and six months ended June 30, 2015 increased $0.3 million, or 10%, and $1.0 million, or 20%, respectively, as compared to the corresponding periods last year, primarily due to an increase in professional service costs as our headcount increased.

Operating Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	% Change	2015	2014	% Change
	(in thousands)			(in thousands)		
Research and development	$18,659	$12,298	52 %	$34,367	$24,246	42 %
Percent of total revenue	29 %	27 %		28 %	27 %	

Research and development expenses increased $6.4 million, or 52%, and $10.1 million, or 42%, for the three and six months ended June 30, 2015, respectively, as compared to the corresponding periods last year. The increases were primarily due to personnel-related cost increases of $5.5 million and $8.9 million for the three and six months periods ended June 30, 2015, respectively, from higher headcount. Additionally, corporate expense increased $0.4 million and $0.7 million, respectively, primarily due to expanded operations. Consulting costs increased $0.3 million and $0.4 million, respectively, due to our growth in both periods.

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	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	% Change		2015	2014	% Change	
	(in thousands)				(in thousands)			
Sales and marketing	$38,017	$24,180	57	%	$70,929	$46,998	51	%
Percent of total revenue	60 %	52 %			58 %	53 %		

Sales and marketing expenses increased $13.8 million, or 57%, and $23.9 million, or 51%, for the three and six months ended June 30, 2015, respectively, as compared to the corresponding periods last year. The increase in headcount on a worldwide basis resulted in increased personnel-related and commissions expenses of $11.1 million and $18.8 million, respectively, which include increases in stock-based compensation expense of $2.7 million and $5.5 million, respectively. Corporate and facilities expenses increased $1.1 million and $2.4 million, respectively, due to higher headcount. Additionally, marketing expenses related to lead generation, trade shows, advertising and other initiatives increased $1.3 million and $2.1 million, respectively. Travel expenses increased $0.5 million for the six months ended June 30, 2015 as compared to the same period last year.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	% Change		2015	2014	% Change	
	(in thousands)				(in thousands)			
General and administrative	$8,495	$6,846	24	%	$15,828	$12,352	28	%
Percent of total revenue	13 %	15 %			13 %	14 %		

General and administrative expenses increased $1.6 million, or 24%, and $3.5 million, or 28%, for the three and six months ended June 30, 2015, respectively, as compared to the corresponding periods last year. The increases were primarily due to increases in personnel costs of $1.4 million and $2.8 million, respectively, from higher headcount. Litigation expense increased $0.3 million and $0.7 million, respectively, due to ongoing litigation with Finjan.

Interest Expense

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	% Change		2015	2014	% Change	
	(in thousands)				(in thousands)			
Interest expense	$(3,332)	$(2,798)	(19	%)	$(6,185)	$(5,571)	(11	)%

The change in interest expense in both comparable periods was primarily due to $0.4 million accretion expense addition in the second quarter of 2015 due to the issuance of the 0.75% Notes in June 2015 (see note 6 to our Condensed Consolidated Financial Statements).

Other Income (Expense), Net

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	% Change		2015	2014	% Change	
	(in thousands)				(in thousands)			
Other income (expense), net	$(80)	$7	1243	%	$(1,260)	$(192)	(556	)%

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The change in other expense, net was insignificant for the three months ended June 30, 2015, as compared to the same period in 2014. Other expense, net increased $1.1 million for the six months ended June 30, 2015, as compared to the corresponding period last year, primarily due to fluctuations in foreign currency exchange rates during the three months ended March 31, 2015.

Provision for Income Taxes

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	% Change	2015	2014	% Change
	(in thousands)			(in thousands)		
Provision for income taxes	$(112)	$(147)	(24)%	$(274)	$(291)	(6)%

The changes in provision for income taxes were insignificant for the three and six months ended June 30, 2015 as compared to the corresponding periods last year.

Liquidity and Capital Resources

As of June 30, 2015, we had $402.1 million in cash and cash equivalents and $8.5 million in short-term investments, for a total of $410.7 million. Also refer to note 6 "Convertible Senior Notes" to the condensed consolidated financial statements for discussion of the Notes.

As of June 30, 2015, we had approximately $8.8 million of cash and cash equivalents at our foreign subsidiaries. We estimated that no material U.S. income taxes would have to be provided if all of the undistributed earnings of the foreign subsidiaries were repatriated back to the United States as substantially all earning from its foreign subsidiaries are previously taxed income.

We plan to grow our customer base by continuing to emphasize investments in sales and marketing to add new customers, expand our customers’ use of our platform, and maintain high renewal rates. We also expect to incur additional cost of subscription revenue in accordance with the resulting growth in our customer base. We believe that the combination of our ongoing improvements in gross margins, the benefits of lower sales and marketing costs associated with our renewal activity, and the fact that our contracts are structured to bill our customers in advance should enable us to improve our cash flow from operations as we grow. Based on our current level of operations and anticipated growth, both of which are expected to be consistent with recent quarters, we believe that our existing sources of liquidity will be sufficient to fund our operations for at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our sales and marketing activities, and the timing and extent of spending to support product development efforts and expansion into new territories, and the timing of introductions of new features and enhancements to our solutions. To the extent that existing cash and cash equivalents and cash from operations are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. We have invested, and plan to continue investing in acquiring complementary businesses, applications and technologies, and may continue to make such investments in the future, any of which could also require us to seek equity or debt financing in addition to our Notes. Additional funds may not be available on terms favorable to us or at all.

Cash Flows

The following table sets forth a summary of our consolidated cash flows for the periods indicated:

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	Six Months Ended June 30, 2015	2014
	(in thousands)	
Net cash provided by (used in) operating activities	$13,553	$(2,822)
Net cash used in investing activities	(16,092)	(20,777)
Net cash provided by financing activities	$224,346	$6,658

Net Cash Flows Provided by (Used in) Operating Activities

Our net loss and cash flows from operating activities are significantly influenced by our investments in headcount and data center operations to support anticipated growth. Our cash flows are also influenced by cash payments from customers. We invoice customers for the entire contract amount at the start of the term, and as such our cash flow from operations is also affected by the length of a customer contract.

Net cash provided by operating activities in the six months ended June 30, 2015 was $13.6 million, as compared to $2.8 million used in the six months ended June 30, 2014. The increase of $16.4 million was primarily due to:

- An increase in amortization of intangible assets of $1.6 million due to the acquisitions made in 2014 and 2015, and an increase in depreciation of fixed assets of $1.8 million due the increase in capital expenditure;
- Stock-based compensation expenses increased $14.4 million due to the increase in headcount and valuation of grants made;
- An increase in deferred revenue change of $13.0 million due to higher billings;
- An increase in accounts payable change of $1.3 million due to the timing of payments;
- The increase was offset by a net loss change of $17.1 million and change in accounts receivable of $2.0 million due to increase in billings and timing of collections.

Net Cash Flows Used in Investing Activities

Our primary investing activities have consisted of the acquisitions of businesses, the sale of short-term investments and capital expenditures 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.

Net cash used in investing activities was $16.1 million in the six months ended June 30, 2015, as compared to $20.8 million used in the six months ended June 30, 2014. The decrease of $4.7 million was due to an $18.0 million increase in proceeds from sale and maturities of short-term investments due to more investments sold or matured. The decrease was offset by $8.9 million paid to acquire businesses, and an increase in capital expenditure of $4.4 million for infrastructure expansion and daily operations.

Net Cash Flows Provided by Financing Activities

Net cash provided by financing activities was $224.3 million in the six months ended June 30, 2015 as compared to $6.7 million provided in the six months ended June 30, 2014. The increase of $217.7 million is primarily due to proceeds of $223.8 million from the issuance of the 0.75% Notes in June 2015 (see note 6 to our Condensed Consolidated Financial Statements), and proceeds from issuance of common stock increased $1.0 million. The increase was partially offset by withholding taxes paid related to restricted stock net share settlement increase of $7.7 million.

Off-Balance Sheet Arrangements

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During the periods presented, we did not have, nor do we currently have, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would 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.

Contractual Obligations and Commitments

Our contractual obligations as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014 have changed due to the issuance of the 0.75% Notes and repayment of all outstanding amounts under the equipment financing loans.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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. 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

We are exposed to market risk related to changes in interest rates. Our investments primarily consist of money market funds, corporate debt securities and certificates of deposit. As of June 30, 2015, we had cash, cash equivalents and short-term investments of $410.7 million. The carrying amount of our cash equivalents and short-term investments reasonably approximates fair value, due to the short maturities of these investments. 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 a fluctuation 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, we believe only dramatic fluctuations in interest rates would have a material effect on our investments. We do not believe that an immediate 10% increase in interest rates would have a material effect on the fair market value of our portfolio. As such we do not expect our operating results or cash flows to be materially affected by a sudden change in market interest rates.

As of June 30, 2015, we had an outstanding balance of $431.3 million aggregate principal amount of the Notes (see note 6 of our Condensed Consolidated Financial Statements). We carry the Notes at face value, less relative fair value of conversion options allocated to equity and unamortized discounts, on our accompanying Condensed Consolidated Balance Sheets. Since these notes bear interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of these notes fluctuates as interest rate changes when the market price of our common stock fluctuates.

Foreign Currency Risk

The functional currency for our wholly owned foreign subsidiaries is the U.S. dollar. Accordingly, the subsidiaries remeasure monetary assets and liabilities at period-end exchange rates, while nonmonetary items are remeasured at historical rates. Income and expense accounts are remeasured at the average exchange rates in effect during the period. Remeasurement adjustments are recognized in the accompanying Condensed Consolidated Statements of Operations as foreign currency transaction gains or losses in the period of occurrence. Aggregate foreign currency transaction loss included in determining net loss was $1.1 million and $0.1 million for the six months ended June 30, 2015 and 2014, respectively. Transaction gains and losses are included in other expense, net.

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. For our operating results and cash flows, we evaluated the effects of a 10% shift in exchange rates between those currencies and the U.S. dollar. We have determined that there would not be a material effect on our results of operations from such a shift. To date, we have not entered into any foreign currency hedging contracts, since exchange rate fluctuations have not had a material impact on our operating results and cash flows. Based on our current international structure, we do not plan on engaging in hedging activities in the near future.

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.

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ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our chief executive officer and chief financial officer concluded that, as of June 30, 2015, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended June 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, the Company may be involved in legal proceedings and subject to claims in the ordinary course of business. On December 16, 2013, Finjan, Inc. sued the Company and its wholly-owned subsidiary, Armorize Technologies, Inc., in the United States District Court, Northern District of California for alleged patent infringement of a variety of its patents, demanding preliminary and permanent injunctive relief, and unspecified damages. The Company and Armorize filed an answer to the complaint on February 10, 2014. On April 15, 2014, Finjan’s initial disclosures in the lawsuit alleged approximately $13,500 in damages, but provided no basis or facts in support of this sum. On April 2, 2015, the court ordered that the claims construction hearing be held in June 2015 and trial be set for March 2016, subject to later adjustment or delay. On April 2, 2015, the court also ordered in part that Finjan amend its infringement contentions to comply with the Patent Local Rules by April 23, 2015. On April 23, 2015, Finjan amended its infringement contentions. On June 24, 2015, the court held the claims construction hearing in this matter and the court’s ruling is now pending. Based on the state of the infringement contentions and evaluation of the facts available at this time, the amount or range of reasonable possible losses to which the Company or Armorize is exposed cannot be estimated and the ultimate resolution of this matter and the associated financial statement impact, if any, remains uncertain at this time. The Company and Armorize intend to vigorously defend the lawsuit. Intellectual property litigation is subject to inherent uncertainties, and there can be no assurance that the expenses associated with defending any litigation or the resolution of this dispute would not have a material adverse impact on the Company's results of operations or cash flows. Regardless of the outcome, such proceedings and claims can have an adverse impact on the Company because of defense and settlement costs, diversion of resources and other factors, and there can be no assurances that favorable outcomes will be obtained.

From time to time, we may be involved in other legal proceedings and subject to claims in the ordinary course of business. Although the results of these proceedings and claims cannot be predicted with certainty, we do not believe the ultimate cost to resolve these matters would individually, or taken together, have a material adverse effect on our business, operating results, cash flows or financial condition. Regardless of the outcome, such proceedings can have an adverse impact on us because of defense and settlement costs, diversion of resources and other factors, and there can be no assurances that favorable outcomes will be obtained.

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ITEM 1A. RISK FACTORS.

Our operations and financial results are subject to various risks and uncertainties, including those described below, which could adversely affect our business, results of operations, cash flows, financial condition, and the trading price of our common stock.

Risks Related to Our Business and Industry

We have a history of losses, and we are unable to predict the extent of any future losses or when, if ever, we will achieve profitability in the future.

We have incurred net losses in every year since our inception, and had net losses of approximately $46.6 million and $29.5 million for the six months ended June, 2015 and 2014, respectively. As a result, we had an accumulated deficit of $320.9 million as of June 30, 2015. Achieving profitability will require us to increase revenue, manage our cost structure, and avoid unanticipated liabilities. We do not expect to be profitable in the near term. Revenue growth may slow or revenue may decline for a number of possible reasons, including slowing demand for our solutions, increasing competition, a decrease in the growth of our overall market, or if we fail for any reason to continue to capitalize on growth opportunities. Any failure by us to obtain and sustain profitability, or to continue our revenue growth, could cause the price of our common stock to decline significantly.

Our quarterly operating results are likely to vary significantly and be unpredictable, which could cause the trading price of our stock to decline.

Our operating results have historically varied from period to period, and we expect that they will continue to do so as a result of a number of factors, many of which are outside of our control and may be difficult to predict, including:

- the level of demand for our solutions, including our newly-introduced solutions, and the level of perceived urgency regarding security threats and compliance requirements;
- the timing of new subscriptions and renewals of existing subscriptions;
- the mix of solutions sold;
- the extent to which customers subscribe for additional solutions or increase the number of users;
- customer budgeting cycles and seasonal buying patterns;
- the extent to which we bring on new distributors;
- any changes in the competitive landscape of our industry, including consolidation among our competitors, customers, partners or resellers;
- timing of costs and expenses during a quarter;
- deferral of orders in anticipation of new solutions or enhancements announced by us;
- price competition;
- changes in renewal rates and terms in any quarter;
- the impact of acquisitions;
- litigation costs;

- any disruption in our sales channels or termination of our relationship with important channel partners;
- general economic conditions, both domestically and in our foreign markets;

- insolvency or credit difficulties confronting our customers, affecting their ability to purchase or pay for our solutions; or

- future accounting pronouncements or changes in our accounting policies.

Any one of the factors above or the cumulative effect of some of the factors referred to above may result in significant fluctuations in our quarterly financial and other operating results, including fluctuations in our key metrics. This variability and unpredictability could result in our failing to meet the expectations of securities analysts or investors for any period. If we fail to meet or exceed such expectations for these or any other reasons, the market price of our shares could fall substantially and we could face costly lawsuits, including securities class action suits. In addition, a significant percentage of our operating expenses are fixed in nature and based on forecasted revenue and cash flow trends. Accordingly, in the event of revenue shortfalls, we are generally unable to mitigate the negative impact on margins or other operating results in the short term.

We may fail to meet or exceed the expectations of securities analysts and investors, and the market price for our common stock and notes could decline. If one or more of the securities analysts who cover us change their recommendation regarding our stock adversely, the market price for our common stock and notes could decline. Additionally, our stock price may be based on expectations, estimates or forecasts of our future performance that may be unrealistic or may not be achieved. Further, our stock price may be affected by financial media, including press reports and blogs.

If we are unable to maintain high subscription renewal rates, our future revenue and operating results will be harmed. Our customers have no obligation to renew their subscriptions for our solutions after the expiration of their initial subscription period, which typically ranges from one to three years. In addition, our customers may renew for fewer subscription services or users, renew for shorter contract lengths or renew at lower prices due to competitive or other pressures. We cannot accurately predict renewal rates and our renewal rates may decline or fluctuate as a result of a number of factors, including competition, customers’ IT budgeting and spending priorities, and deteriorating general economic conditions. If our customers do not renew their subscriptions for our solutions, our revenue would decline and our business would suffer.

If we are unable to sell additional solutions to our customers, our future revenue and operating results will be harmed.

Our future success depends on our ability to sell additional solutions to our customers. This may require increasingly sophisticated and costly sales efforts and may not result in additional sales. In addition, the rate at which our customers purchase additional solutions depends on a number of factors, including the perceived need for additional solutions, growth in the number of end-users, and general economic conditions. If our efforts to sell additional solutions to our customers are not successful, our business may suffer.

If our solutions fail to protect our customers from security breaches, our brand and reputation could be harmed, which could have a material adverse effect on our business and results of operations.

The threats facing our customers are constantly evolving and the techniques used by attackers to access or sabotage data change frequently. As a result, we must constantly update our solutions to respond to these threats. If we fail to update our solutions in a timely or effective manner to respond to these threats, our customers could experience security breaches. Many federal, state and foreign governments have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, and any association of us with such publicity may cause our customers to lose confidence in the effectiveness of our data security measures. Any security breach at one of our customers would harm our reputation as a secure and trusted company and could cause the loss of customers.

Similarly, if a well-publicized breach of data security at a customer of any other cloud based data protection or archiving service provider or other major enterprise cloud services provider were to occur, there could be a loss of confidence in the cloud based storage of sensitive data and information generally.

In addition, our solutions work in conjunction with a variety of other elements in customers' IT and security infrastructure, and we may receive blame and negative publicity for a security breach that may have been the result of the failure of one of the other elements not provided by us. The occurrence of a breach, whether or not caused by our solutions, could delay or reduce market acceptance of our solutions and have an adverse effect on our business and financial performance. In addition, any revisions to our solutions that we believe may be necessary or appropriate in connection with any such breach may cause us to incur significant expenses. Any of these events could have material adverse effects on our brand and reputation, which could harm our business, financial condition, and operating results.

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If our customers experience data losses, our brand, reputation and business could be harmed.
Our customers rely on our archive solutions to store their corporate data, which may include financial records, credit card information, business information, health information, other personally identifiable information or other sensitive personal information. A breach of our network security and systems or other events that cause the loss or public disclosure of, or access by third parties to, our customers' stored files or data could have serious negative consequences for our business, including possible fines, penalties and damages, reduced demand for our solutions, an unwillingness of our customers to use our solutions, harm to our brand and reputation, and time-consuming and expensive litigation. The techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently, often are not recognized until launched against a target, and may originate from less regulated or remote areas around the world. As a result, we may be unable to proactively prevent these techniques, implement adequate preventative or reactionary measures, or enforce the laws and regulations that govern such activities. In addition, because of the large amount of data that we collect and manage, it is possible that hardware failures, human errors or errors in our systems could result in data loss or corruption, or cause the information that we collect to be incomplete or contain inaccuracies that our customers regard as significant. If our customers experience any data loss, or any data corruption or inaccuracies, whether caused by security breaches or otherwise, our brand, reputation and business would be harmed.

Our errors and omissions insurance may be inadequate or may not be available in the future on acceptable terms, or at all. In addition, our policy may not cover any claim against us for loss of data or other indirect or consequential damages. Defending a suit based on any data loss or system disruption, regardless of its merit, could be costly and divert management's attention.

Defects or vulnerabilities in our solutions could harm our reputation, reduce the sales of our solutions and expose us to liability for losses.
Because our solutions are complex, undetected errors, failures or bugs may occur, especially when solutions are first introduced or when new versions or updates are released despite our efforts to test those solutions and enhancements prior to release. We may not be able to correct defects, errors, vulnerabilities or failures promptly, or at all.
Any defects, errors, vulnerabilities or failures in our solutions could result in:

- expenditure of significant financial and development resources in efforts to analyze, correct, eliminate or work around errors or defects or to address and eliminate vulnerabilities;
- loss of existing or potential partners or customers;
- loss or disclosure of our customers' confidential information, or the inability to access such information;
- loss of our proprietary technology;
- our solutions being susceptible to hacking or electronic break-ins or otherwise failing to secure data;
- delayed or lost revenue;
- delay or failure to attain market acceptance;
- lost market share;
- negative publicity, which could harm our reputation; or
- litigation, regulatory inquiries or investigations that would be costly and harm our reputation.

Limitation of liability provisions in our standard terms and conditions and our other agreements may not adequately or effectively protect us from any claims related to defects, errors, vulnerabilities or failures in our solutions, including as a result of federal, state or local laws or ordinances or unfavorable judicial decisions in the United States or other countries.
Because we provide security solutions, our software, website and internal systems may be subject to intentional disruption that could adversely impact our reputation and future sales.

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We could be a target of attacks specifically designed to impede the performance of our solutions and harm our reputation. Similarly, experienced computer hackers may attempt to penetrate our network security or the security of our website and misappropriate proprietary information and/or cause interruptions of our services. Because the techniques used by such computer hackers to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. If an actual or perceived breach of network security occurs, it could adversely affect the market perception of our solutions, and may expose us to the loss of information, litigation and possible liability. In addition, such a security breach could impair our ability to operate our business, including our ability to provide support services to our customers.

We believe that there is a trend for large and mid sized enterprises to migrate their on premise email systems to cloud based offerings. If we fail to successfully develop, market, broaden or enhance our solutions to continue to be attractive to existing customers currently using cloud based email systems or to new prospects, our ability to grow or maintain our revenue could be harmed, and our business could suffer.

We derive a substantial portion of our revenue from our solutions that protect and archive data in our customers' on-premise email systems and expect to continue to do so for the foreseeable future. We currently derive a portion of our revenue from customers using cloud-based email systems such as Google's Google Apps and Microsoft's Office 365, both of which include varying degrees of threat protection and governance services as part of their offering. A significant market shift from on premise email systems toward such cloud based email systems could decrease demand for our solutions because customers who move to cloud based email systems may no longer value our threat and governance solutions and may choose to instead use competing or low cost alternatives from companies such as Google or Microsoft that may offer competing solutions in connection with their cloud-based email systems. If our current or prospective customers who utilize cloud based systems fail to find value in our solutions or migrate to these other threat or governance offerings, our business could be adversely affected.

Our solutions collect, filter and archive customer data which may contain personal information, which raises privacy concerns and could result in us having liability or inhibit sales of our solutions.

Many federal, state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations regarding the collection, use, and disclosure of personal information. Because many of the features of our solutions use, store, and report on customer data which may contain personal information from our customers, any inability to adequately address privacy concerns, or comply with applicable privacy laws, regulations and policies could, even if unfounded, result in liability to us, damage to our reputation, loss of sales, and harm to our business. Furthermore, the costs of compliance with, and other burdens imposed by, such laws, regulations and policies that are applicable to the businesses of our customers may limit the use and adoption of our solutions and reduce overall demand for them. Privacy concerns, whether or not valid, may inhibit market adoption of our solutions. For example, in the United States regulations such as the Gramm Leach Bliley Act, which protects and restricts the use of consumer credit and financial information, and the Health Insurance Portability and Accountability Act of 1996 (HIPAA), which regulates the use and disclosure of personal health information, impose significant security and data protection requirements and obligations on businesses that may affect the use and adoption of our solutions. The European Union's Data Protection Directive requires member states to impose restrictions on the collection and use of personal data that, in some respects, are more stringent, and impose more significant burdens on subject businesses, than current privacy standards in the United States.

The regulatory framework for privacy issues is evolving worldwide, and various government and consumer agencies and public advocacy groups have called for new regulation and changes in industry practices. It is possible that new laws and regulations will be adopted in the United States and internationally, or existing laws and regulations may be interpreted in new ways, that would affect our business. Complying with any new regulatory requirements could force us to incur substantial costs or require us to change our business practices in a manner that could reduce our revenue or compromise our ability to effectively pursue our growth strategy.

Any failure or perceived failure to comply with laws and regulations may result in proceedings or actions against us by government entities or others, or could cause us to lose users and customers, which could potentially have an adverse effect on our business.

We operate in a highly competitive environment with large, established competitors, and our competitors may gain market share in the markets for our solutions that could adversely affect our business and cause our revenue to decline.

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Our traditional competitors include security focused software vendors, such as Symantec Corporation and McAfee, Inc., an Intel Corporation subsidiary, which offer software products that directly compete with our solutions. In addition to competing with these vendors directly for sales to customers, we compete with them for the opportunity to have our solutions bundled with the product offerings of our strategic partners. Our competitors could gain market share from us if any of these partners replace our solutions with the products of our competitors or if these partners more actively promote our competitors' products over our solutions. In addition, software vendors who have bundled our solutions with theirs may choose to bundle their software with their own or other vendors' software, or may limit our access to standard product interfaces and inhibit our ability to develop solutions for their platform.

We also face competition from large technology companies, such as Cisco, Google Inc., Hewlett Packard Company, Intel and Microsoft. These companies are increasingly developing and incorporating into their products data protection and storage software that compete on various levels with our solutions. Our competitive position could be adversely affected to the extent that our customers perceive that the functionality incorporated into these products would replace the need for our solutions or that buying from one vendor would provide them with increased leverage and purchasing power and a better customer experience. We also face competition from independent security vendors such as FireEye, Inc. that offer network security products and many smaller companies that specialize in particular segments of the markets in which we compete.

Many of our competitors have greater financial, technical, sales, marketing or other resources than we do and consequently may have the ability to influence our customers to purchase their products instead of ours. Further consolidation within our industry or other changes in the competitive environment could also result in larger competitors that compete with us on several levels. In addition, acquisitions of smaller companies by large technology companies that specialize in particular segments of the markets in which we compete would result in increased competition from these large technology companies. For example, Cisco's acquisition of IronPort, an email and web security service, resulted in Cisco becoming one of our competitors. If we are unsuccessful in responding to our competitors or to changing technological and customer demands, our competitive position and financial results could be adversely affected.

If we do not effectively expand and train our sales force, we may be unable to add new customers or increase sales to our existing customers and our business will be harmed.

We continue to be substantially dependent on our sales force to obtain new customers and to sell additional solutions to our existing customers. We believe that there is significant competition for sales personnel with the skills and technical knowledge that we require. Our ability to achieve significant revenue growth will depend, in large part, on our success in recruiting, training and retaining sufficient numbers of sales personnel to support our growth. New hires require significant training and may take significant time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals in the markets where we do business or plan to do business. If we are unable to hire and train sufficient numbers of effective sales personnel, or the sales personnel are not successful in obtaining new customers or increasing sales to our existing customer base, our business will be harmed.

Our sales cycle is long and unpredictable, and our sales efforts require considerable time and expense. As a result, our results are difficult to predict and may vary substantially from quarter to quarter, which may cause our operating results to fluctuate.

We sell our security and compliance offerings primarily to enterprise IT departments that are managing a growing set of user and compliance demands, which has increased the complexity of customer requirements to be met and confirmed in the sales cycle. Additionally, we have found that increasingly security, legal and compliance departments are involved in testing, evaluating and finally approving purchases, which has also made the sales cycle longer and less predictable. We may not be able to accurately predict or forecast the timing of sales, which makes our future revenue difficult to predict and could cause our results to vary significantly. In addition, we might devote substantial time and effort to a particular unsuccessful sales effort, and as a result we could lose other sales opportunities or incur expenses that are not offset by an increase in revenue, which could harm our business.

Our cash flow is dependent in part upon our average contract durations, so significant shortening of our average contract durations may cause significant negative impact to our operating results.
With the majority of our business, we invoice our customers for the entire contract amount at the start of the term and these amounts are recorded as deferred revenue on our balance sheet, with the dollar weighted average duration of these contracts for any given period over the past three years typically ranging from 16 to 22 months. As a result, while our practice of

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invoicing customers for the entire amount of the contract at the start of the term provides us with a relatively immediate contribution to cash flow, the revenue is recognized ratably over the term of the contract, and hence contributions toward operating income are realized over an extended period. If these average contract durations were to shorten significantly from their current range, it may cause us to experience less favorable cash flows as compared to our current operating condition, requiring us to seek additional sources of capital to fund our operations.

Because our long-term success depends, in part, on our ability to expand the sales of our platform to our customers located outside of the United States, our business will be increasingly susceptible to risks associated with international operations.

One key element of our growth strategy is to develop a worldwide customer base and expand our operations worldwide. Our international revenue keeps growing as we add employees, offices and customers internationally, particularly in Europe and Asia.

Operating in international markets requires significant resources and management attention and will subject us to regulatory, economic, political and competitive risks and competition that are different from those in the United States. Because of our limited experience with international operations, we cannot assure you that our international expansion efforts will be successful or that expected returns on such investments will be achieved in the future.

In addition, our international operations may fail to succeed due to other risks inherent in operating businesses internationally, including:

- fluctuations in currency exchange rates, which may cause our revenues and operating results to differ materially from expectations;
- our lack of familiarity with commercial and social norms and customs in other countries which may adversely affect our ability to recruit, retain and manage employees in these countries;
- difficulties and costs associated with staffing and managing foreign operations;
- the potential diversion of management’s attention to oversee and direct operations that are geographically distant from our U.S. headquarters;
- compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy and data protection laws and regulations;
- legal systems in which our ability to enforce and protect our rights may be different or less effective than in the United States, including more limited protection for intellectual property rights in some countries;
- immaturity of compliance regulations in other jurisdictions, which may lower demand for our solutions;
- greater difficulty with payment collections and longer payment cycles;
- higher employee costs and difficulty terminating non-performing employees;
- differences in work place cultures;
- the need to adapt our solutions for specific countries;
- our ability to comply with differing technical and certification requirements outside the United States;
- tariffs, export controls and other non-tariff barriers such as quotas and local content rules;
- adverse tax consequences;
- restrictions on the transfer of funds;
- anti-bribery compliance by us or our partners, including under the Foreign Corrupt Practices Act; and
- new and different sources of competition.

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Our failure to manage any of these risks successfully could harm our existing and future international operations and seriously impair our overall business.

If the market for our delivery model and cloud computing services develops more slowly than we expect, our business could be harmed.

Our success will depend to a substantial extent on the willingness of enterprises, large and small, to increase their use of cloud computing services. The market for messaging security and data compliance solutions delivered as a service in particular is at an early stage relative to on-premise solutions, and these applications may not achieve and sustain high levels of demand and market acceptance. Many enterprises have invested substantial personnel and financial resources to integrate traditional enterprise software or hardware appliances for these applications into their businesses or may be reluctant or unwilling to use cloud computing services because they have concerns regarding the risks associated with reliability and security, among other things, of this delivery model, or its ability to help them comply with applicable laws and regulations. If enterprises do not perceive the benefits of this delivery model, then the market for our services may develop more slowly than we expect, which would adversely affect our business and operating results.

If we are unable to enhance our existing solutions and develop new solutions, our growth will be harmed and we may not be able to achieve profitability.

Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing solutions and to introduce new solutions. The success of any enhancement or new solution depends on several factors, including the timely completion, introduction and market acceptance of the enhancement or solution. Any new enhancement or solution we develop or acquire may not be introduced in a timely or cost-effective manner and may not achieve the broad market acceptance necessary to generate significant revenue. If we are unable to successfully develop or acquire new solutions or enhance our existing solutions to meet customer requirements, we may not grow as expected and we may not achieve profitability.

We cannot be certain that our development activities will be successful or that we will not incur delays or cost overruns. Furthermore, we may not have sufficient financial resources to identify and develop new technologies and bring enhancements or new solutions to market in a timely and cost-effective manner. New technologies and enhancements could be delayed or cost more than we expect, and we cannot ensure that any of these solutions will be commercially successful if and when they are introduced.

If we are unable to cost-effectively scale or adapt our existing architecture to accommodate increased traffic, technological advances or changing customer requirements, our operating results could be harmed.

As our customer base grows, the number of users accessing our solutions over the Internet will correspondingly increase. Increased traffic could result in slow access speeds and response times. Since our customer agreements often include service availability commitments, slow speeds or our failure to accommodate increased traffic could result in breaches of our service level agreements or obligate us to issue service credits. In addition, the market for our solutions is characterized by rapid technological advances and changes in customer requirements. In order to accommodate increased traffic and respond to technological advances and evolving customer requirements, we expect that we will be required to make future investments in our network architecture. If we do not implement future upgrades to our network architecture cost-effectively, or if we experience prolonged delays or unforeseen difficulties in connection with upgrading our network architecture, our service quality may suffer and our operating results could be harmed.

If we fail to manage our sales and distribution channels effectively or if our partners choose not to market and sell our solutions to their customers, our operating results could be adversely affected.

We have derived and anticipate that in the future we will continue to derive a substantial portion of the sales of our solutions through channel partners. In order to scale our channel program to support growth in our business, it is important that we continue to help our partners enhance their ability to independently sell and deploy our solutions. We may be unable to continue to successfully expand and improve the effectiveness of our channel sales program.

Our agreements with our channel partners are generally non-exclusive and some of our channel partners have entered, and may continue to enter, into strategic relationships with our competitors or are competitors themselves. Further, many of our channel partners have multiple strategic relationships and they may not regard us as significant for their businesses. Our channel partners may terminate their respective relationships with us with limited or no notice and with limited or no penalty, pursue other partnerships or relationships, or attempt to develop or acquire products or services that compete with our solutions. Our partners also may impair our ability to enter into other desirable strategic relationships. If our channel partners do not effectively market and sell our solutions, if they choose to place greater emphasis on products of their own or those offered by our competitors, or if they fail to meet the needs of our customers, our ability to grow our business and sell our solutions may be adversely affected. Similarly, the loss of a substantial number of our channel partners, and our possible inability to replace them, the failure to recruit additional channel partners, any reduction or delay in their sales of our solutions, or any conflicts between channel sales and our direct sales and marketing activities could materially and adversely affect our results of operations.

Because we recognize revenue from subscriptions over the term of the relevant service period, decreases or increases in sales are not immediately reflected in full in our operating results.
We recognize revenue from subscriptions over the term of the relevant service period, which typically range from one to three years, with some up to five years. As a result, most of our quarterly revenue from subscriptions results from agreements entered into during previous quarters. Consequently, a shortfall in demand for our solutions in any quarter may not significantly reduce our subscription revenue for that quarter, but could negatively affect subscription revenue in future quarters. We may be unable to adjust our cost structure to compensate for this potential shortfall in subscription revenue. Accordingly, the effect of significant downturns in sales of subscriptions may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our subscription revenue through additional sales in any period, as subscription revenue must be recognized over the term of the contract.

Interruptions or delays in services provided by third parties could impair the delivery of our service and harm our business.

We currently serve our customers from third party data center facilities and resources located in the United States, Canada and Europe. We also rely on bandwidth providers, Internet service providers, and mobile networks to deliver our solutions. Any damage to, or failure of, the systems of our third party providers could result in interruptions to our service. If for any reason our arrangement with one or more of our data centers is terminated we could experience additional expense in arranging for new facilities and support. Our data center facilities providers have no obligations to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew our agreements with the facilities providers on commercially reasonable terms or if in the future we add additional data center facility providers, we may experience costs or downtime in connection with the transfer to, or the addition of, new data center facilities. In addition, the failure of our data centers to meet our capacity requirements could result in interruptions in the availability of our solutions, impair the functionality of our solutions or impede our ability to scale our operations. As we continue to add data centers, restructure our data management plans, and increase capacity in existing and future data centers, we may move or transfer our data and our customers' data. Despite precautions taken during such processes and procedures, any unsuccessful data transfers may impair the delivery of our service, and we may experience costs or downtime in connection with the transfer of data to other facilities.

We also depend on access to the Internet through third party bandwidth providers to operate our business. If we lose the services of one or more of our bandwidth providers, or if these providers experience outages, for any reason, we could experience disruption in delivering our solutions or we could be required to retain the services of a replacement bandwidth provider. Our business also depends on our customers having high-speed access to the Internet. Any Internet outages or delays could adversely affect our ability to provide our solutions to our customers.

Our operations also rely heavily on the availability of electricity, which also comes from third party providers. If we or the third party data center facilities that we use to deliver our services were to experience a major power outage or if the cost of electricity were to increase significantly, our operations and financial results could be harmed. If we or our third party data centers were to experience a major power outage, we or they would have to rely on back-up generators, which might not work properly or might not provide an adequate supply during a major power outage. Such a power outage could result in a significant disruption of our business.

The occurrence of an extended interruption of our or third party services for any reason could result in lengthy interruptions in our services or in the delivery of customers' email and require us to provide service credits, refunds, indemnification payments or other payments to our customers, and could also result in the loss of customers.

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

Once our solutions are deployed, our customers depend on our support organization to resolve any technical issues relating to our solutions. In addition, our sales process is highly dependent on our solutions and business reputation and on strong recommendations from our existing customers. Any failure to maintain high-quality technical support, or a market perception that we do not maintain high-quality support, could harm our reputation, adversely affect our ability to sell our solutions to existing and prospective customers, and harm our business, operating results and financial condition.

We offer technical support services with many of our solutions. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services. We also may be unable to modify the format of our support services to compete with changes in support services provided by competitors. Increased customer demand for these services, without corresponding revenue, could increase costs and adversely affect our operating results.

We have outsourced a substantial portion of our worldwide customer support functions to third party service providers. If these companies experience financial difficulties, do not maintain sufficiently skilled workers and resources to satisfy our contracts, or otherwise fail to perform at a sufficient level, the level of support services to our customers may be significantly disrupted, which could materially harm our reputation and our relationships with these customers.

If we fail to develop or protect our brand, our business may be harmed.

We believe that developing and maintaining awareness and integrity of our company and our brand are important to achieving widespread acceptance of our existing and future offerings and are important elements in attracting new customers. We believe that the importance of brand recognition will increase as competition in our market further intensifies. Successful promotion of our brand will depend on the effectiveness of our marketing efforts and on our ability to provide reliable and useful solutions at competitive prices. We plan to continue investing substantial resources to promote our brand, both domestically and internationally, but there is no guarantee that our brand development strategies will enhance the recognition of our brand. Some of our existing and potential competitors have well-established brands with greater recognition than we have. If our efforts to promote and maintain our brand are not successful, our operating results and our ability to attract and retain customers may be adversely affected. In addition, even if our brand recognition and loyalty increases, this may not result in increased use of our solutions or higher revenue.

In addition, independent industry analysts often provide reviews of our solutions, as well as those of our competitors, and perception of our solutions in the marketplace may be significantly influenced by these reviews. We have no control over what these industry analysts report, and because industry analysts may influence current and potential customers, our brand could be harmed if they do not provide a positive review of our solutions or view us as a market leader.

The steps we have taken to protect our intellectual property rights may not be adequate.

We rely on a combination of contractual rights, trademarks, trade secrets, patents and copyrights to establish and protect our intellectual property rights. These offer only limited protection, however, and the steps we have taken to protect our proprietary technology may not deter its misuse, theft or misappropriation. Any of our patents, copyrights, trademarks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. Competitors may independently develop technologies or products that are substantially equivalent or superior to our solutions or that inappropriately incorporate our proprietary technology into their products. Competitors may hire our former employees who may misappropriate our proprietary technology or misuse our confidential information. Although we rely in part upon confidentiality agreements with our employees, consultants and other third parties to protect our trade secrets and other confidential information, those agreements may not effectively prevent disclosure of trade secrets and other confidential information and may not provide an adequate remedy in the event of misappropriation of trade secrets or unauthorized disclosure of confidential information. In addition, others may independently discover our trade secrets and confidential information, and in such cases we could not assert any trade secret rights against such parties.

We might be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our intellectual property rights or misappropriation of our trade secrets, or to establish the validity of our intellectual property rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel, which may adversely affect our business, operating results and financial condition. Certain jurisdictions may not provide adequate legal infrastructure for effective protection of our intellectual property rights. Changing legal interpretations of liability for unauthorized use of our solutions or lessened sensitivity by corporate, government or institutional users to refraining from intellectual property piracy or other infringements of intellectual property could also harm our business.

Our issued patents may not provide us with any competitive advantages or may be challenged by third parties, and our patent applications may never be granted at all. It is possible that innovations for which we seek patent protection may not be protectable. Additionally, the process of obtaining patent protection is expensive and time consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. Given the cost, effort, risks and downside of obtaining patent protection, including the requirement to ultimately disclose the invention to the public, we may not choose to seek patent protection for certain innovations. However, such patent protection could later prove to be important to our business. Even if issued, there can be no assurance that any patents will have the coverage originally sought or adequately protect our intellectual property, as the legal standards relating to the validity, enforceability and scope of protection of patent and other intellectual property rights are uncertain. Any patents that are issued may be invalidated or otherwise limited, or may lapse or may be abandoned, enabling other companies to better develop products that compete with our solutions, which could adversely affect our competitive business position, business prospects and financial condition.

We cannot assure you that the measures we have taken to protect our intellectual property will adequately protect us, and any failure to protect our intellectual property could harm our business.

Third parties claiming that we infringe their intellectual property rights could cause us to incur significant legal expenses and prevent us from selling our solutions.

Companies in the software and technology industries, including some of our current and potential competitors, own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement, misappropriation or other violations of intellectual property rights. In addition, many of these companies have the capability to dedicate substantially greater resources to enforce their intellectual property rights and to defend claims that may be brought against them. The litigation may involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our potential patents may provide little or no deterrence. We have received, and may in the future receive, notices that claim we have infringed, misappropriated or otherwise violated other parties' intellectual property rights. For example, on December 16, 2013, Finjan, Inc. sued the Company and Armorize in the United States District Court, Northern District, of California for alleged patent infringement. To the extent we gain greater visibility, we could face a higher risk of being the subject of intellectual property infringement claims, which is not uncommon with respect to software technologies in general and information security technology in particular. There may be third party intellectual property rights, including issued or pending patents that cover significant aspects of our technologies or business methods. Any intellectual property claims, with or without merit, could be very time consuming, could be expensive to settle or litigate and could divert our management's attention and other resources. These claims could also subject us to significant liability for damages, potentially including treble damages if we are found to have willfully infringed patents or copyrights. These claims could also result in our having to stop using technology found to be in violation of a third-party's rights. We might be required to seek a license for the intellectual property, which may not be available on reasonable terms or at all. Even if a license were available, we could be required to pay significant royalties, which would increase our operating expenses. As a result, we may be required to develop alternative non-infringing technology, which could require significant effort and expense. If we cannot license or develop technology for any infringing aspect of our business, we would be forced to limit or stop sales of one or more of our solutions or features of our solutions and may be unable to compete effectively. Any of these results would harm our business, operating results and financial condition.

In addition, our agreements with customers and channel partners include indemnification provisions under which we agree to indemnify them for losses suffered or incurred as a result of claims of intellectual property infringement and, in some cases, for damages caused by us to property or persons. Large indemnity payments could harm our business, operating results and financial condition.

We rely on technology and intellectual property licensed from other parties, the failure or loss of which could increase our costs and delay or prevent the delivery of our solutions.

We utilize various types of software and other technology, as well as intellectual property rights, licensed from unaffiliated third parties in order to provide certain elements of our solutions. Any errors or defects in any third party technology could result in errors in our solutions that could harm our business. In addition, licensed technology and intellectual property rights may not continue to be available on commercially reasonable terms, or at all. While we believe that there are currently adequate replacements for the third party technology we use, any loss of the right to use any of this technology on commercially reasonable terms, or at all, could result in delays in producing or delivering our solutions until equivalent technology is identified and integrated, which delays could harm our business. In this situation we would be required to either redesign our solutions to function with software available from other parties or to develop these components ourselves, which would result in increased costs. Furthermore, we might be forced to limit the features available in our current or future solutions. If we fail to maintain or renegotiate any of these technology or intellectual property licenses, we could face significant delays and diversion of resources in attempting to develop similar or replacement technology, or to license and integrate a functional equivalent of the technology.

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

Some of our solutions are distributed with software licensed by its authors or other third parties under so-called "open source" licenses, which may include, by way of example, the GNU General Public License, or GPL, and the Apache License. Some of these licenses contain requirements that we make available source code for modifications or derivative works we create based upon the open source software, and that we license such modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use. By the terms of certain open source licenses, we could be required to release the source code of our proprietary software, and to make our proprietary software available under open source licenses, if we combine our proprietary software with open source software in a certain manner. In the event that portions of our proprietary software are determined to be subject to an open source license, we could be required to publicly release the affected portions of our source code, re-engineer all or a portion of our technologies, or otherwise be limited in the licensing of our technologies, each of which could reduce or eliminate the value of our technologies and solutions. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or controls on the origin of the software. We have established processes to help alleviate these risks, including a review process for screening requests from our development organizations for the use of open source software, but we cannot be sure that all open source software is submitted for approval prior to use in our solutions, that our programmers have not incorporated open source software into our proprietary solutions and technologies or that they will not do so in the future. In addition, many of the risks associated with usage of open source software cannot be eliminated, and could, if not properly addressed, negatively affect our business.

Governmental regulations affecting the export of certain of our solutions could negatively affect our business.
Some of our products are subject to U.S. export controls, and we incorporate encryption technology into certain of our products. These encryption products and the underlying technology may be exported outside the United States only with the required export authorizations, including by license, a license exception or other appropriate government authorizations, including the filing of an encryption registration. Governmental regulation of encryption technology and regulation of imports or exports, or our failure to obtain required import or export approval for our products, could harm our international sales and adversely affect our revenue.
Failure to comply with such regulations in the future could result in penalties, costs, and restrictions on export privileges, which could also harm our operating results.
We have experienced rapid growth in recent periods. If we fail to manage such growth and our future growth effectively, we may be unable to execute our business plan, maintain high levels of service or adequately address competitive challenges.
We have experienced significant growth in recent periods. For example, we grew full-time employee headcount 26% from December 31, 2013 to December 31, 2014. This growth has placed, and any future growth may place, a significant strain on our management and operational infrastructure, including our hosting operations. Our success will depend, in part, on our ability to manage these changes effectively. We will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. Failure to effectively manage growth could result in declines in service quality or customer satisfaction, increases in costs, difficulties in introducing new features or other operational difficulties. Any failure to effectively manage growth could adversely impact our business and reputation.
We have, and may further, expand through acquisitions of, or investments in, other companies, which may divert our management's attention, dilute our stockholders and consume corporate resources that otherwise would be necessary to sustain and grow our business.
We have made multiple acquisitions in 2013 and 2014, and most recently in July 2015, and our business strategy may, from time to time, continue to include acquiring complementary products, technologies or businesses. We also may

enter into relationships with other businesses in order to expand our solutions, which could involve preferred or exclusive licenses, additional channels of distribution, or investments by or between the two parties. Negotiating these transactions can be time consuming, difficult and expensive, and our ability to close these transactions may be subject to third party approvals, such as government regulation, which are beyond our control. Consequently, we can make no assurance that these transactions, once undertaken and announced, will close.

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These kinds of transactions may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel or operations of acquired companies, particularly if the key personnel of the acquired business choose not to work for us, and we may have difficulty retaining the customers of any acquired business. Acquisitions may also disrupt our ongoing business, divert our resources and require significant management attention that would otherwise be available for development of our business. Any acquisition or investment could expose us to unknown liabilities. In addition, as of June 30, 2015, we had $160.5 million in goodwill and intangible assets, net of accumulated amortization, recorded on our accompanying Condensed Consolidated Balance Sheets. We will incur expenses related to the amortization of intangible assets and we may in the future need to incur charges with respect to the write-down or impairment of goodwill or intangible assets, which could adversely affect our operating results. Moreover, we cannot assure you that the anticipated benefits of any acquisition or investment would be realized or that we would not be exposed to unknown liabilities. In connection with these types of transactions, we may issue additional equity securities that would dilute our stockholders, use cash that we may need in the future to operate our business, incur debt on terms unfavorable to us or that we are unable to repay, incur large charges or substantial liabilities, encounter difficulties integrating diverse business cultures, and become subject to adverse tax consequences, substantial depreciation or deferred compensation charges. These challenges related to acquisitions or investments could adversely affect our business, operating results and financial condition.

If we are unable to attract and retain qualified employees, lose key personnel, fail to integrate replacement personnel successfully, or fail to manage our employee base effectively, we may be unable to develop new and enhanced solutions, effectively manage or expand our business, or increase our revenue.

Our future success depends upon our ability to recruit and retain key management, technical, sales, marketing, finance, and other critical personnel. Competition for qualified management, technical and other personnel is intense, and we may not be successful in attracting and retaining such personnel. If we fail to attract and retain qualified employees, our ability to grow our business could be harmed. Our officers and other key personnel are employees-at-will, and we cannot assure you that we will be able to retain them. Competition for people with the specific skills that we require is significant. In order to attract and retain personnel in a competitive marketplace, we believe that we must provide a competitive compensation package, including cash and equity based compensation. Volatility in our stock price may from time to time adversely affect our ability to recruit or retain employees. If we are unable to hire and retain qualified employees, or conversely, if we fail to manage employee performance or reduce staffing levels when required by market conditions, our business and operating results could be adversely affected.

In addition, hiring, training, and successfully integrating replacement personnel could be time consuming, may cause additional disruptions to our operations, and may be unsuccessful, which could negatively impact future revenue.

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

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication and business applications. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting data privacy and the use of the Internet as a commercial medium. Changes in these laws or regulations could require us to modify our solutions in order to comply with these changes. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet or commerce conducted via the Internet. These laws or charges could limit the growth of Internet related commerce or communications generally, result in a decline in the use of the Internet and the viability of Internet based applications such as ours and reduce the demand for our solutions.

The legal and regulatory framework also drives demand for our solutions. Our customers are subject to laws, regulations and internal policies that mandate how they process, handle, store, use and transmit a variety of sensitive data and communications. These laws and regulations are subject to revision, change and interpretation at any time, and any such change could either help or hurt the demand for our solutions. We cannot be sure that the legal and regulatory framework in any given jurisdiction will be favorable to our business or that we will be able to sustain or grow our business if there are any adverse changes to these laws and regulations.

If we are required to collect sales and use taxes on the solutions we sell, we may be subject to liability for past sales and our future sales may decrease.

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State and local taxing jurisdictions have differing rules and regulations governing sales and use taxes, and these rules and regulations are subject to varying interpretations that may change over time. In particular, the applicability of sales taxes to our subscription services in various jurisdictions is unclear. It is possible that we could face sales tax audits and that our liability for these taxes could exceed our estimates as state tax authorities could still assert that we are obligated to collect additional amounts as taxes from our customers and remit those taxes to those authorities. We could also be subject to audits with respect to state and international jurisdictions for which we have not accrued tax liabilities. A successful assertion that we should be collecting additional sales or other taxes on our services in jurisdictions where we have not historically done so and do not accrue for sales taxes could result in substantial tax liabilities for past sales, discourage customers from purchasing our application or otherwise harm our business and operating results.

Adverse conditions in the national and global economies and financial markets may adversely affect our business and financial results.
Our financial performance depends, in part, on the state of the economy, which deteriorated in the recent broad recession, and which may deteriorate in the future. Challenging economic conditions worldwide have from time to time contributed, and may continue to contribute, to slowdowns in the information technology industry, resulting in reduced demand for our solutions as a result of continued constraints on IT-related capital spending by our customers and increased price competition for our solutions. Moreover, we target some of our solutions to the financial services industry and therefore if there is consolidation in that industry, or layoffs, or lack of funding for IT purchases, our business may suffer. If unfavorable economic conditions continue or worsen, our business, financial condition and operating results could be materially and adversely affected.

Our business is subject to the risks of earthquakes, fire, power outages, floods and other catastrophic events, and to interruption by manmade problems such as terrorism.
Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. We have significant operations in the Silicon Valley area of Northern California, a region known for seismic activity. A major earthquake or other natural disaster, fire, act of terrorism or other catastrophic event that results in the destruction or disruption of any of our critical business operations or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be harmed. These negative events could make it difficult or impossible for us to deliver our services to our customers, and could decrease demand for our services. Because we do not carry earthquake insurance for direct quake related losses, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

A portion of our revenue is generated by sales to government entities, which are subject to a number of challenges and risks.

Sales to U.S. and foreign federal, state and local governmental agency customers have accounted for a portion of our revenue in past periods, and we may in the future increase sales to government entities. Sales into government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that we will win a sale. We have invested in the creation of a cloud offering that has been certified under both the Federal Information Security Management Act and the Federal Risk and Authorization Management Program for government usage but we cannot be sure that we will continue to sustain or renew this certification, that the government will continue to mandate such certification or that other government agencies or entities will use this cloud offering. Government demand and payment for our solutions may be impacted by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our solutions. Government entities may have contractual or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our future results of operations. For example, if the distributor receives a significant portion of its revenue from sales to such governmental entity, the financial health of the distributor could be substantially harmed, which could negatively affect our future sales to such distributor. Governments routinely investigate and audit government contractors' administrative processes, and any unfavorable audit could result in the government refusing to continue buying our solutions, a reduction of revenue or fines or civil or criminal liability if the audit uncovers improper or illegal activities. Any such penalties could adversely impact our results of operations in a material way.

If we fail to maintain an effective system of internal controls, our ability to produce timely and accurate financial statements or comply with applicable regulations could be impaired.

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As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes Oxley Act of 2002, or the Sarbanes Oxley Act, and the rules and regulations of the NASDAQ Global Market. We expect that the requirements of these rules and regulations will continue to increase our legal, accounting and financial compliance costs, make some activities more difficult, time consuming and costly, and place significant strain on our personnel, systems and resources.

The Sarbanes Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. We are continuing to develop and refine our disclosure controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file with the Securities and Exchange Commission, or the SEC, is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that information required to be disclosed in reports under the Exchange Act is accumulated and communicated to our principal executive and financial officers.

Our current controls and any new controls that we develop may become inadequate because of changes in conditions in our business. Further, weaknesses in our internal controls may be discovered in the future. Any failure to develop or maintain effective controls, or any difficulties encountered in their implementation or improvement, could harm our operating results or cause us to fail to meet our reporting obligations and may result in a restatement of our financial statements for prior periods. Any failure to implement and maintain effective internal controls also could adversely affect the results of periodic management evaluations and annual independent registered public accounting firm report regarding the effectiveness of our internal control over financial reporting that we are required to include in our Annual Report on Form 10-K we will file with the SEC under Section 404 of the Sarbanes Oxley Act. Ineffective disclosure controls and procedures and internal control over financial reporting could also cause investors to lose confidence in our reported financial and other information, which would likely have a negative effect on the trading price of our common stock.

In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, we have expended, and anticipate that we will continue to expend, significant resources, including accounting related costs, and provide significant management oversight. Any failure to maintain the adequacy of our internal controls, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In the event that we or our independent registered public accounting firm are not able to complete the work required under Section 404 of the Sarbanes-Oxley Act on a timely basis, or we are not able to demonstrate compliance with Section 404, we could be subject to late filings of our annual and quarterly reports, restatements of consolidated financial statements or other corrective disclosure, and, investors may lose confidence in our operating results and our stock price could decline. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on The NASDAQ Global Market.

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

As of June 30, 2015, we had federal and state net operating loss carryforwards due to prior period losses, which if not utilized will begin to expire in 2018 and 2015 for federal and state purposes, respectively. We also have federal research tax credit carryforwards, which if not utilized will begin to expire in 2022. These net operating loss and research tax credit carryforwards could expire unused and be unavailable to offset future income tax liabilities, which could adversely affect our profitability.

In addition, under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the “Internal Revenue Code”), our ability to utilize net operating loss carryforwards or other tax attributes, such as research tax credits, in any taxable year may be limited if we experience an “ownership change.” An “ownership change” generally occurs if one or more stockholders or groups of stockholders who own at least 5% of our stock increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. Similar rules may apply under state tax laws.

Future issuances of our stock could cause an "ownership change." It is possible that any future ownership change could have a material effect on the use of our net operating loss carryforwards or other tax attributes, which could adversely affect our profitability.

We have been incurring significantly increased costs and devoting substantial management time as a result of operating as a public company.

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. For example, we are required to comply with certain of the requirements of the Sarbanes Oxley Act and the Dodd Frank Wall Street Reform and Consumer Protection Act, as well as rules and regulations subsequently implemented by the SEC,

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and the NASDAQ Global Market, our stock exchange, including the establishment and maintenance of effective disclosure and financial controls and changes in corporate governance practices. We expect that compliance with these requirements will continue to increase our legal and financial compliance costs and will make some activities more time consuming and costly. In addition, we expect that our management and other personnel will need to divert attention from operational and other business matters to devote substantial time to these public company requirements.

We have incurred and expect to continue to incur significant expenses and devote substantial management effort toward ensuring compliance with the requirements of Section 404 of the Sarbanes Oxley Act. We will need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. We cannot predict or estimate the amount of additional costs we may incur as a public company or the timing of such costs.

Risks Related to the Ownership of Our Common Stock

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

The trading price of our common stock has been volatile historically, and is likely to continue to be subject to wide fluctuations in response to various factors described below. These factors, as well as the volatility of our common stock, could also impact the price of our convertible notes. Factors affecting the market price of our securities include:

- variations in our revenue, billings, gross margin, operating results, free cash flow, loss per share and how these results compare to analyst expectations;
- forward looking guidance that we may provide regarding financial metrics such as billings, revenue, gross margin, operating results, free cash flow, and loss per share;
- announcements of technological innovations, new products or services, strategic alliances, acquisitions or significant agreements by us or by our competitors;
- disruptions in our cloud-based operations or services or disruptions of other prominent cloud-based operations or services;
- the economy as a whole, market conditions in our industry, and the industries of our customers;
- trading activity by directors, executive officers and significant stockholders, or the perception in the market that the holders of a large number of shares intend to sell their shares;
- the size of our market float and significant option exercises;
- any future issuances of securities;
- sales and purchases of any common stock issued upon conversion of our convertible notes; and
- any other factors discussed herein.

In addition, the stock markets in general and the NASDAQ Global Market in particular, have experienced substantial price and volume volatility that is often seemingly unrelated to the operating results of any particular companies. Moreover, if the market for technology stocks, especially security and cloud computing-related stocks, or the stock market in general experiences uneven investor confidence, the market price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The market price for our stock might also decline in reaction to events that affect other companies within, or outside, our industry, even if these events do not directly affect us. Some companies that have experienced volatility in the trading price of their stock have been subject of securities litigation. If we are the subject of such litigation, it could result in substantial costs and a diversion of management’s attention and resources.

We have indebtedness in the form of convertible senior notes.

In December 2013, we completed an offering of $201.3 million aggregate principal amount of 1.25% convertible senior notes due 2018 and in June 2015, we completed an offering of $230.0 million aggregate principal amount of

0.75% convertible senior notes due 2020 (collectively - the "Notes"). As a result of these convertible notes offerings, we incurred $431.3 million principal amount of indebtednesses, the principal amounts of which we may be required to pay at maturity in 2018 and 2020, or, upon the occurrence of a make-whole fundamental changes (as defined in the indentures). There can be no assurance that we will be able to repay these indebtednesses when due, or that we will be able to refinance these indebtednesses on acceptable terms or at all. In addition, these indebtednesses could, among other things:

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

Conversion of our Notes may affect the price of our common stock and the value of the Notes.

The conversion of some or all of our Notes may dilute the ownership interest of existing stockholders to the extent we deliver shares of common stock upon conversion. Holders of the Notes will be able to convert them only upon the satisfaction of certain conditions prior to June 15, 2018 and December 15, 2019. Upon conversion, holders of the Notes will receive cash, shares of common stock or a combination of cash and shares of common stock, at our election. Any sales in the public market of shares of common stock issued upon conversion of such Notes could adversely affect the trading price of our common stock and the value of the Notes.

Anti-takeover provisions contained in our certificate of incorporation, bylaws and debt documents, as well as provisions of Delaware law, could impair a takeover attempt.

Our certificate of incorporation and bylaws contain provisions that could have the effect of rendering more difficult, delaying or preventing an acquisition of our company deemed undesirable by our board of directors. These provisions could also reduce the price that investors might be willing to pay in the future for shares of our common stock and result in the market price of our common stock being lower than it would be without these provisions. Our corporate governance documents include provisions:

- creating a classified board of directors whose members serve staggered three-year terms;
- authorizing "blank check" preferred stock, which could be issued by our board without stockholder approval which may contain voting, liquidation, dividend and other rights which are superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings by providing that any stockholder action must be effected at a duly called meeting of the stockholders and not by a consent in writing, and providing that only our board of directors, the chairman of our board of directors, our Chief Executive Officer or President may call a special meeting of the stockholders; and
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors.

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

In addition, the fundamental changes provisions of our Notes may delay or prevent a change in control of our company, because those provisions allow note holders to require us to repurchase such Notes upon the occurrence of a fundamental change (as defined in the indenture for the Notes). Furthermore, the indenture for the Notes prohibits us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the Notes.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from

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engaging in certain business combinations merging or combining with us without approval of the holders of a substantial majority of all of our outstanding common stock.

Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new solutions could reduce our ability to compete and could harm our business.

We may need to raise additional funds, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests and the per share value of our common stock could decline. If we issue equity securities in any additional financing, the new securities may have rights and preferences senior to our common stock. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop or enhance our application and services;
- continue to expand our product development, sales and marketing organizations;
- acquire complementary technologies, products or businesses;
- expand operations, in the United States or internationally;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Future sales of our common stock in the public market could lower the market price for our common stock and adversely impact the trading price of the notes.

In the future, we may sell additional shares of our common stock to raise capital. In addition, a substantial number of shares of our common stock is reserved for issuance upon the exercise of stock options, the vesting of restricted stock units and restricted stock pursuant to our employee benefit plans, for purchase by employees under our employee stock purchase plan, and upon conversion of the notes. We cannot predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the trading price of the notes and the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

We do not anticipate paying cash dividends, and accordingly, stockholders must rely on stock appreciation for any return on their investment.

We do not anticipate paying cash dividends on our common stock in the future. As a result, only appreciation of the price of our common stock will provide a return to our stockholders. Investors seeking cash dividends should not invest in our common stock.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

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ITEM 6. EXHIBITS.

EXHIBIT INDEX

Exhibit No.	Exhibit	Incorporated by Reference Form	File No.	Filing Date	Exhibit No.	Filed Herewith
4.01	Indenture dated June 17, 2015 between the Company and Wells Fargo (including the form of 0.75% Convertible Promissory Notes due 2020)	8-K	15937502	6/17/2015	4.1	
31.01	Certification of Periodic Report by Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002					X
31.02	Certification of Periodic Report by Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002					X
32.01*	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					X
32.02*	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					X
101.INS	XBRL Instance Document.					X
101.SCH	XBRL Taxonomy Extension Schema Document.					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.					X

* These exhibits are furnished with this Quarterly Report on Form 10-Q and are not deemed filed with the Securities and Exchange Commission and are not incorporated by reference in any filing of Proofpoint, Inc. under the Securities Act of 1933 or the Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in such filings.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Sunnyvale, State of California, on August 6, 2015.

PROOFPOINT, INC.

By: /s/ GARY STEELE
Gary Steele
Chief Executive Officer
(Principal Executive Officer)

By: /s/ PAUL AUVIL
Paul Auvil
Chief Financial Officer
(Principal Financial and Accounting Officer)