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ServiceNow, Inc.

Form 10-Q

November 04, 2016

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2016

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
Commission File Number: 001-35580

## SERVICENOW, INC.

(Exact name of registrant as specified in its charter)

Delaware 20-2056195  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

ServiceNow, Inc.

2225 Lawson Lane

Santa Clara, California 95054

(408) 501-8550

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

As of September 30, 2016, there were approximately 166.0 million shares of the Registrant's Common Stock outstanding.



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**PART I****ITEM 1. FINANCIAL STATEMENTS****SERVICENOW, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS***(in thousands)*

	September 30, 2016 (Unaudited)	December 31, 2015
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$325,067	\$412,305
Short-term investments	481,813	388,945
Accounts receivable, net	220,089	203,333
Current portion of deferred commissions	62,657	51,976
Prepaid expenses and other current assets	37,281	29,076
Total current assets	1,126,907	1,085,635
Deferred commissions, less current portion	44,597	33,016
Long-term investments	281,353	422,667
Property and equipment, net	176,106	144,714
Intangible assets, net	60,726	43,005
Goodwill	84,425	55,669
Other assets	39,000	22,346
Total assets	\$1,813,114	\$1,807,052
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$30,012	\$37,369
Accrued expenses and other current liabilities	124,670	101,264
Current portion of deferred revenue	743,657	593,003
Total current liabilities	898,339	731,636
Deferred revenue, less current portion	18,048	10,751
Convertible senior notes, net	499,280	474,534
Other long-term liabilities	34,944	23,317
Total liabilities	1,450,611	1,240,238
Stockholders' equity:		
Common stock	165	160
Additional paid-in capital	1,343,604	1,140,545
Accumulated other comprehensive loss	(16,465 )	(16,882 )
Accumulated deficit	(964,801 )	(557,009 )
Total stockholders' equity	362,503	566,814
Total liabilities and stockholders' equity	\$1,813,114	\$1,807,052

*See accompanying notes to condensed consolidated financial statements*

**SERVICENOW, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**  
**(Unaudited)**

(in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues:				
Subscription	\$318,934	\$223,208	\$877,035	\$603,576
Professional services and other	38,722	37,942	127,812	116,254
Total revenues	357,656	261,150	1,004,847	719,830
Cost of revenues <sup>(1)</sup> :				
Subscription	61,566	46,053	170,707	133,889
Professional services and other	41,271	35,835	123,039	104,615
Total cost of revenues	102,837	81,888	293,746	238,504
Gross profit	254,819	179,262	711,101	481,326
Operating expenses <sup>(1)</sup> :				
Sales and marketing	166,491	117,899	511,607	364,530
Research and development	75,018	55,822	211,306	158,946
General and administrative	40,085	33,581	117,393	93,357
Legal settlements	—	—	270,000	—
Total operating expenses	281,594	207,302	1,110,306	616,833
Loss from operations	(26,775 )	(28,040 )	(399,205 )	(135,507 )
Interest expense	(8,389 )	(7,839 )	(24,746 )	(23,124 )
Interest and other income (expense), net	1,783	(3,952 )	4,745	1,273
Loss before provision for income taxes	(33,381 )	(39,831 )	(419,206 )	(157,358 )
Provision for income taxes	2,877	1,199	9	3,690
Net loss	\$(36,258 )	\$(41,030 )	\$(419,215 )	\$(161,048 )
Net loss per share - basic and diluted	\$(0.22 )	\$(0.26 )	\$(2.56 )	\$(1.04 )
Weighted-average shares used to compute net loss per share - basic and diluted	165,378,836	156,930,506	163,767,329	154,352,037
Other comprehensive gain (loss):				
Foreign currency translation adjustments	\$203	\$(2,689 )	\$(1,106 )	\$(3,028 )
Unrealized gain (loss) on investments, net of tax	(615 )	(111 )	1,523	69
Other comprehensive gain (loss), net of tax	(412 )	(2,800 )	417	(2,959 )
Comprehensive loss	\$(36,670 )	\$(43,830 )	\$(418,798 )	\$(164,007 )

(1) Includes stock-based compensation as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenues:				
Subscription	\$7,140	\$5,951	\$20,698	\$17,183
Professional services and other	7,150	5,804	20,045	16,788
Sales and marketing	31,898	26,011	95,757	74,690
Research and development	21,376	18,130	62,956	51,703
General and administrative	13,523	9,215	35,004	29,167
Total stock-based compensation	\$81,087	\$65,111	\$234,460	\$189,531



*See accompanying notes to condensed consolidated financial statements*

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**SERVICENOW, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
*(in thousands)*

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$(419,215)	\$(161,048)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	59,716	43,957
Amortization of premiums on investments	3,745	5,380
Amortization of deferred commissions	57,742	48,055
Amortization of debt discount and issuance costs	24,746	23,124
Stock-based compensation	234,460	189,531
Deferred income tax	(5,095)	)
Other	(857)	) (5,393)
Changes in operating assets and liabilities, net of effect of business combinations:		
Accounts receivable	(15,761)	) (5,303)
Deferred commissions	(79,190)	) (54,168)
Prepaid expenses and other assets	(11,733)	) (8,915)
Accounts payable	(8,625)	) 8,312
Deferred revenue	151,019	115,812
Accrued expenses and other liabilities	36,282	11,856
Net cash provided by operating activities <sup>(1)</sup>	27,234	211,200
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(84,112)	) (62,588)
Business combinations, net of cash acquired	(34,297)	) (1,100)
Purchases of other intangibles	(14,850)	)
Purchases of investments	(434,397)	) (543,167)
Purchases of strategic investments	—	(10,000)
Sales of investments	266,288	242,631
Maturities of investments	218,452	203,632
Restricted cash	(322)	) (408)
Net cash used in investing activities	(83,238)	) (171,000)
<b>Cash flows from financing activities:</b>		
Proceeds related to deferred payments on purchase of other intangibles	4,100	—
Payments related to deferred payments on purchase of other intangibles	(1,025)	)
Proceeds from employee stock plans	55,063	73,347
Taxes paid related to net share settlement of equity awards	(88,567)	) (12,603)
Payments on financing obligation	(336)	) (112)
Net cash (used in) provided by financing activities <sup>(1)</sup>	(30,765)	) 60,632
Foreign currency effect on cash and cash equivalents	(469)	) (4,214)
Net (decrease) increase in cash and cash equivalents	(87,238)	) 96,618
Cash and cash equivalents at beginning of period	412,305	252,455
Cash and cash equivalents at end of period	\$325,067	\$349,073
<b>Supplemental disclosures of non-cash investing activities:</b>		
Property and equipment included in accounts payable and accrued expenses	\$9,691	\$14,381

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During the nine months ended September 30, 2016, we early adopted Accounting Standards Update 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." Refer to Note 2 Recent Accounting Pronouncements for further details. This adoption (1) resulted in a \$1.2 million increase in net cash provided by operating activities and a corresponding \$1.2 million decrease in net cash provided by financing activities for the nine months ended September 30, 2015.

*See accompanying notes to condensed consolidated financial statements*

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**SERVICENOW, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

*Unless the context requires otherwise, references in this report to "ServiceNow," the "Company", "we," "us," and "our" refer to ServiceNow, Inc. and its consolidated subsidiaries.*

**(1) Description of the Business**

ServiceNow is a leading provider of enterprise cloud computing solutions that define, structure, manage and automate services across the global enterprise. Our mission is to help the modern enterprise operate faster and be more scalable by applying a service-oriented lens to the activities, tasks and processes that comprise day-to-day work life.

**(2) Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared in accordance with the applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles, or GAAP, for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for fair statement of results for the interim periods presented have been included. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the year ended December 31, 2016 or for other interim periods or for future years. The condensed consolidated balance sheet as of December 31, 2015 is derived from audited financial statements as of that date, however, it does not include all of the information and footnotes required by GAAP for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on February 25, 2016.

***Principles of Consolidation***

The condensed consolidated financial statements have been prepared in conformity with GAAP and include our accounts and the accounts of our wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

***Prior Period Reclassification***

Certain reclassifications of prior period amounts have been made to conform to the current period presentation.

***Use of Estimates***

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Warranties and Indemnification***

Our cloud computing solutions are typically warranted to perform in material conformance with their specifications.

We include service level commitments to our customers that permit those customers to receive credits in the event we fail to meet those service levels. We establish an accrual based on an evaluation of the known service disruptions. Service level credit accrual charges are recorded against revenue and were not material for all periods presented.

We have also agreed to indemnify our directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person's service as a director or officer, including any action by us, arising out of that person's services as a director or officer of our company or that person's services provided to any other company or enterprise at our request. We maintain director and officer insurance coverage that may enable us to recover a portion of any future amounts paid. The fair values of these obligations are not material as of each balance sheet date.

Our agreements include provisions indemnifying customers against intellectual property and other third-party claims. We have not incurred any costs as a result of such indemnification obligations and have not recorded any liabilities related to such obligations in the condensed consolidated financial statements.

### *New Accounting Pronouncements Adopted in 2016*

In March 2016, the FASB issued ASU 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This standard is effective for our interim and annual reporting periods beginning January 1, 2017, and early adoption is permitted. We elected to early adopt this standard in the quarter ended June 30, 2016. The impact of the early adoption was as follows:

The standard eliminates additional paid in capital (APIC) pools and requires excess tax benefits and tax deficiencies to be recorded in the income statement as a discrete item when the awards vest or are settled. The adoption of this guidance on a prospective basis resulted in the recognition of excess tax benefits in our provision for income taxes of \$0.3 million and \$2.0 million for the three and nine months ended September 30, 2016, respectively.

The standard requires excess tax benefits to be recognized regardless of whether the benefit reduces taxes payable. The adoption of this guidance on a modified retrospective basis resulted in the recognition of a cumulative-effect adjustment of \$11.4 million that reduced our accumulated deficit and increased our foreign long-term deferred income tax as of January 1, 2016. The previously unrecognized U.S. excess tax effects were recorded as a deferred tax asset net of a valuation allowance.

We have elected to continue to estimate forfeitures expected to occur to determine the amount of stock-based compensation cost to be recognized in each period. As such, the guidance relating to forfeitures did not have an impact on our accumulated deficit as of January 1, 2016.

We elected to apply the statement of cash flows guidance that cash flows related to excess tax benefits be presented as an operating activity retrospectively, which resulted in a \$1.2 million increase to net cash provided by operating activities and a corresponding decrease to net cash provided by financing activities in the accompanying condensed consolidated statement of cash flows for the nine months ended September 30, 2015, as compared to the amounts previously reported.

The statement of cash flows guidance that cash flows related to employee taxes paid for withheld shares be presented as a financing activity had no impact on our condensed consolidated financial statements as we have historically presented such cash flows as a financing activity.

In September 2015, the FASB issued ASU 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments (Topic 805)," which eliminates the requirement to restate prior period financial statements for measurement period adjustments in business combinations. This new standard requires that the cumulative impact of a

measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. We adopted this standard during the three months ended March 31, 2016 on a prospective basis and the adoption had no material impact on our condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes software. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. We adopted this standard during the three months ended March 31, 2016 on a prospective basis and the adoption had no material impact on our condensed consolidated financial statements.

***Pending Accounting Pronouncements***

In October 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory," which includes a revision of the accounting for the income tax consequences of intra-entity transfers of assets other than inventory to reduce the complexity in accounting standards. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017, and early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," which provides guidance on eight specific cash flow issues. Among these issues, this standard requires, at the settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowings, the portion of the cash payment attributable to the accreted interest related to the debt discount to be classified as cash flows for operating activities, and the portion of the cash payments attributable to the principal to be classified as cash outflows for financing activities. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017, and early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which requires a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This standard is effective for our interim and annual reporting periods beginning after December 15, 2019. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets, and to recognize on the income statement the expenses in a manner similar to current practice. This new standard is effective for our interim and annual periods beginning January 1, 2019 and early adoption is permitted. While we are currently evaluating the impact of this standard on our condensed consolidated financial statements, we anticipate this standard will have a material impact on our condensed consolidated balance sheets given that we have operating lease commitments of approximately \$300 million as of September 30, 2016. However, we do not anticipate this standard will have a material impact on our condensed consolidated statements of comprehensive loss since the expense recognition under this new standard will be similar to current practice.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This new standard is effective for our interim and annual periods beginning January 1, 2018 and early adoption is not permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which will supersede virtually all existing revenue guidance. Under this standard, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This standard should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in the retained earnings. In March 2016, the FASB issued ASU 2016-08,



"Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the principal versus agent guidance in the new revenue recognition standard. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which clarifies the guidance on accounting for licenses of intellectual property (IP) and identifying performance obligations in the new revenue recognition standard. In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," which amended the revenue recognition guidance regarding collectability, non-cash consideration, presentation of sales tax and transition. These new standards are effective for our interim and annual periods beginning January 1, 2018 and early adoption beginning January 1, 2017 is permitted. We are currently evaluating the impact of these standards on our condensed consolidated financial statements and have not yet selected the transition method.

**(3) Investments****Marketable Securities**

The following is a summary of our available-for-sale investment securities, excluding those securities classified within cash and cash equivalents on the consolidated balance sheets (in thousands):

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Commercial paper	\$61,726	\$ —	\$ —	\$61,726
Corporate notes and bonds	629,143	513	(553 )	629,103
Certificates of deposit	33,417	—	—	33,417
U.S. government agency securities	38,908	26	(14 )	38,920
Total available-for-sale securities	\$763,194	\$ 539	\$ (567 )	\$763,166

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Commercial paper	\$32,430	\$ 2	\$(38 )	\$32,394
Corporate notes and bonds	617,054	7	(2,027 )	615,034
Certificates of deposit	29,610	2	(17 )	29,595
U.S. government agency securities	134,962	1	(374 )	134,589
Total available-for-sale securities	\$814,056	\$ 12	\$(2,456 )	\$811,612

As of September 30, 2016, the contractual maturities of our investments did not exceed 24 months. The fair values of available-for-sale investments, by remaining contractual maturity, are as follows (in thousands):

	September 30, 2016
Due in 1 year or less	\$481,813
Due in 1 year through 2 years	281,353
Total	\$763,166

We had certain available-for-sale securities in a gross unrealized loss position, substantially all of which had been in such position for less than 12 months. There were no impairments considered "other-than-temporary" as it is more likely than not we will hold the securities until maturity or a recovery of the cost basis. The following table shows the fair values and the gross unrealized losses of these securities, classified by the length of time that the securities have been in a continuous unrealized loss position, and aggregated by investment types (in thousands):

	September 30, 2016					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate notes and bonds	\$367,093	\$(553 )	\$600	\$	—\$367,693	\$(553 )
U.S. government agency securities	21,401	(14 )	—	—	21,401	(14 )
Total	\$388,494	\$(567 )	\$600	\$	—\$389,094	\$(567 )



	December 31, 2015					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Commercial paper	\$24,913	\$(38 )	\$—	\$—	\$24,913	\$(38 )
Corporate notes and bonds	539,586	(1,897 )	60,099	(130 )	599,685	(2,027 )
Certificates of deposit	19,750	(17 )	—	—	19,750	(17 )
U.S. government agency securities	132,581	(374 )	—	—	132,581	(374 )
Total	\$716,830	\$(2,326 )	\$60,099	\$(130 )	\$776,929	\$(2,456 )

### *Strategic Investments*

We account for our investments in non-marketable equity securities of certain privately-held companies under the cost method, as we have less than a 20% ownership interest and we do not have the ability to exercise significant influence over the operations of these companies. The carrying value of these investments was \$10.5 million as of September 30, 2016 and December 31, 2015, which is included in "Other assets" on the condensed consolidated balance sheets.

#### **(4) Fair Value Measurements**

The following table presents our fair value hierarchy for our assets measured at fair value on a recurring basis at September 30, 2016 (in thousands):

	Level 1	Level 2	Total
Cash equivalents:			
Money market funds	\$114,850	\$—	\$114,850
Short-term investments:			
Commercial paper	—	61,726	61,726
Corporate notes and bonds	—	376,862	376,862
Certificates of deposit	—	32,712	32,712
U.S. government agency securities	—	10,513	10,513
Long-term investments:			
Corporate notes and bonds	—	252,240	252,240
Certificates of deposit	—	705	705
U.S. government agency securities	—	28,408	28,408
Total	\$114,850	\$763,166	\$878,016

The following table presents our fair value hierarchy for our assets measured at fair value on a recurring basis at December 31, 2015 (in thousands):

	Level 1	Level 2	Total
Cash equivalents:			
Money market funds	\$263,515	\$—	\$263,515
Commercial paper	—	2,000	2,000
Corporate notes and bonds	—	1,119	1,119
Short-term investments:			
Commercial paper	—	32,394	32,394
Corporate notes and bonds	—	303,567	303,567
Certificates of deposit	—	23,736	23,736
U.S. government agency securities	—	29,248	29,248
Long-term investments:			
Corporate notes and bonds	—	311,467	311,467
Certificates of deposit	—	5,859	5,859
U.S. government agency securities	—	105,341	105,341
Total	\$263,515	\$814,731	\$1,078,246

We determine the fair value of our security holdings based on pricing from our service provider and market prices from industry-standard independent data providers. Such market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs), such as yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures.

See Note 9 for the fair value measurement of our convertible senior notes.

## (5) Business Combinations

### *BrightPoint Security*

On June 3, 2016, we completed the acquisition of a privately-held company, BrightPoint Security, Inc. (BrightPoint), by acquiring all issued and outstanding common shares of BrightPoint for approximately \$19.6 million in an all-cash transaction to expand our security operations solutions. The following table summarizes the allocation of the purchase price to the fair value of the tangible and intangible assets acquired and liabilities assumed as of the acquisition date:

	Purchase Price Allocation (in thousands)	Useful Life (in years)
Intangible assets:		
Developed technology	\$8,100	6
Customer contracts and related relationships	500	1.5
Goodwill	15,258	
Net tangible liabilities acquired	(1,339 )	
Net deferred tax liabilities <sup>(1)</sup>	(2,890 )	
Total purchase price	\$19,629	

(1) Deferred tax liabilities, net primarily relates to purchased identifiable intangible assets and is shown net of deferred tax assets.



**ITapp**

On April 8, 2016, we completed the acquisition of a privately-held company, ITapp Inc. (ITapp), by acquiring all issued and outstanding common shares of ITapp for approximately \$14.5 million in an all-cash transaction to expand our IT operations management solutions. The following table summarizes the allocation of the purchase price to the fair value of the tangible and intangible assets acquired and liabilities assumed as of the acquisition date:

	<b>Purchase Price Allocation (in thousands)</b>	<b>Useful Life (in years)</b>
Net tangible assets acquired	\$ 140	
Intangible assets:		
Developed technology	4,700	5
Customer contracts and related relationships	200	1.5
Goodwill	11,437	
Net deferred tax liabilities	(2,015 )	
Total purchase price	\$ 14,462	

For both business combinations, the excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. We believe the goodwill represents the synergies expected from expanded market opportunities when integrating the acquired technologies with our offerings. The goodwill balance for both business combinations is not deductible for income tax purposes. Acquisition-related costs of \$1.0 million are included in general and administrative expenses in our consolidated statements of comprehensive loss.

The results of operations of both BrightPoint and ITapp have been included in our condensed consolidated financial statements from their respective dates of purchase. These business combinations did not have a material impact on our condensed consolidated financial statements, and therefore historical and pro forma disclosures have not been presented.

**(6) Goodwill and Intangible Assets**

Goodwill balances are presented below (in thousands):

	<b>Carrying Amount</b>
Balance as of December 31, 2015	\$55,669
Goodwill acquired	26,695
Foreign currency translation adjustments	2,061
Balance as of September 30, 2016	\$84,425

Intangible assets consist of the following (in thousands):

	<b>September 30, 2016</b>		
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
Developed technology	\$80,453	\$(27,580 )	\$52,873
Other	9,275	(1,422 )	7,853
Total intangible assets	\$89,728	\$(29,002 )	\$60,726

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December 31, 2015

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
Developed technology	\$58,144	\$(17,463 )	\$40,681
Other	3,695	(1,371 )	2,324
Total intangible assets	\$61,839	\$(18,834 )	\$43,005



Amortization expense for intangible assets for the three months ended September 30, 2016 and 2015 was approximately \$4.3 million and \$2.9 million, respectively, and for the nine months ended September 30, 2016 and 2015 was approximately \$10.9 million and \$8.8 million, respectively.

## (7) Property and Equipment

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

	September 30, 2016	December 31, 2015
Computer equipment and software	\$238,661	\$180,197
Leasehold improvements	35,418	31,659
Furniture and fixtures	29,981	26,017
Building	6,570	6,318
Construction in progress	5,088	1,886
	315,718	246,077
Less: Accumulated depreciation	(139,612 )	(101,363 )
Total property and equipment, net	\$176,106	\$144,714

Construction in progress consists primarily of leasehold improvements and in-process software development costs. Depreciation expense for the three months ended September 30, 2016 and 2015 was \$17.9 million and \$12.2 million, respectively, and for the nine months ended September 30, 2016 and 2015 was \$48.7 million and \$35.1 million, respectively.

## (8) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Taxes payable	\$11,452	\$9,080
Bonuses and commissions	46,253	33,124
Accrued compensation	25,724	17,089
Other employee related liabilities	18,602	21,529
Other	22,639	20,442
Total accrued expenses and other current liabilities	\$124,670	\$101,264

## (9) Convertible Senior Notes

In November 2013, we issued 0% convertible senior notes due November 1, 2018 with an aggregate principal amount of \$575 million, or the Notes. The Notes will not bear interest. The Notes mature on November 1, 2018 unless converted or repurchased in accordance with their terms prior to such date. We cannot redeem the Notes prior to maturity.

The Notes are unsecured obligations and do not contain any financial covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. Upon conversion, we may choose to pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock. We intend to settle the principal amount of the Notes with cash.



The Notes are convertible up to 7.8 million shares of our common stock at an initial conversion rate of approximately 13.54 shares of common stock per \$1,000 principal amount, which is equal to an initial conversion price of approximately \$73.88 per share of common stock, subject to adjustment. Holders of the Notes may convert their Notes at their option at any time prior to the close of business on the business day immediately preceding July 1, 2018, only under the following circumstances:

during any calendar quarter commencing after the calendar quarter ending on March 31, 2014 (and only during such calendar quarter), if the last reported sale price of the common stock 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 immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

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

upon the occurrence of specified corporate events.

On or after July 1, 2018, a holder may convert all or any portion of its notes at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date regardless of the foregoing conditions. Upon conversion, we will pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election.

The conversion price will be subject to adjustment in some events. Holders of the Notes who convert their notes in connection with certain corporate events that constitute a “make-whole fundamental change” are, under certain circumstances, entitled to an increase in the conversion rate. Additionally, in the event of a corporate event that constitutes a “fundamental change,” holders of the Notes may require us to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, at a purchase price equal to 100% of the principal amount of the Notes plus any accrued and unpaid interest.

In accounting for the issuance of the Notes, we separated the Notes into liability and equity components. The carrying cost of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes. The difference between the principal amount of the Notes and the proceeds allocated to the liability component, or the debt discount, is amortized to interest expense using the effective interest method over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the issuance of the Notes, we allocated the total amount incurred to the liability and equity components based on their relative fair values. Transaction costs attributable to the liability component are being amortized to interest expense over the term of the Notes, and transaction costs attributable to the equity component were netted with the equity component of the Notes in stockholders’ equity. The Notes consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Liability:		
Principal	\$575,000	\$575,000
Less: debt issuance cost and debt discount, net of amortization	(75,720 )	(100,466 )
Net carrying amount	\$499,280	\$474,534

We consider the fair value of the Notes at September 30, 2016 and December 31, 2015 to be a Level 2 measurement. The estimated fair values of the Notes were \$701.8 million and \$741.8 million at September 30, 2016 and December 31, 2015, respectively (based on the closing trading price per \$100 of the Notes on September 30, 2016 and December 31, 2015, respectively). The Notes were not convertible as of September 30, 2016 and December 31, 2015.

As of September 30, 2016, the remaining life of the Notes is 25 months. The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Amortization of debt issuance cost	\$450	\$420	\$1,327	\$1,240
Amortization of debt discount	7,939	7,419	23,419	21,884
Total	\$8,389	\$7,839	\$24,746	\$23,124
Effective interest rate of the liability component	6.5%			

### *Note Hedge*

To minimize the impact of potential economic dilution upon conversion of the Notes, we entered into convertible note hedge transactions, or the Note Hedge, with respect to our common stock concurrent with the issuance of the Notes. The Note Hedge covers approximately 7.8 million shares of our common stock at a strike price per share that corresponds to the initial conversion price of the Notes, subject to adjustment, and is exercisable upon conversion of the Notes. We paid an aggregate amount of \$135.8 million for the Note Hedge. The Note Hedge will expire upon maturity of the Notes. The Note Hedge is intended to reduce the potential economic dilution upon conversion of the Notes in the event that the fair value per share of our common stock at the time of exercise is greater than the conversion price of the Notes. The Note Hedge is a separate transaction and is not part of the terms of the Notes. The Note Hedge does not impact earnings per share, as it was entered into to offset any dilution from the Notes.

### *Warrants*

Separately, we entered into warrant transactions, or the Warrants, whereby we sold warrants to acquire up to 7.8 million shares of our common stock, at a strike price of \$107.46 per share, subject to adjustment. We received aggregate proceeds of \$84.5 million from the sale of the Warrants. If the average market value per share of our common stock for the reporting period, as measured under the Warrants, exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on our earnings per share. The Warrants are separate transactions and are not remeasured through earnings each reporting period. The Warrants are not part of the Notes or the Note Hedge, and have been accounted for as part of additional paid-in capital.

### **(10) Accumulated Other Comprehensive Loss**

The components of accumulated other comprehensive loss, net of tax, consist of the following (in thousands):

	September 30,	December 31,
	2016	2015
Foreign currency translation adjustment	\$(15,544)	\$(14,438)
Net unrealized loss on investments, net of tax	(921)	(2,444)
Accumulated other comprehensive loss	\$(16,465)	\$(16,882)

Reclassification adjustments out of accumulated other comprehensive loss into net loss were immaterial for all periods presented.



**(11) Stockholders' Equity*****Common Stock***

We were authorized to issue 600,000,000 shares of common stock as of September 30, 2016. Holders of our common stock are not entitled to receive dividends unless declared by our board of directors. As of September 30, 2016, we had 166,011,100 shares of common stock outstanding and had reserved shares of common stock for future issuance as follows:

	September 30, 2016
Stock option plans:	
Options outstanding	6,475,548
RSUs	12,834,324
Stock awards available for future grants:	
2012 Equity Incentive Plan <sup>(1)</sup>	21,051,913
2012 Employee Stock Purchase Plan <sup>(1)</sup>	8,566,803
Total reserved shares of common stock for future issuance	48,928,588

(1) Refer to Note 12 for a description of these plans.

During the nine months ended September 30, 2016 and 2015, we issued a total of 5,225,336 shares and 8,586,233 shares, respectively, from stock option exercises, vesting of restricted stock units, or RSUs, net of employee payroll taxes and purchases from the employee stock purchase plan, or ESPP.

**(12) Stock Awards**

We have a 2005 Stock Option Plan, or 2005 Plan, which provides for grants of stock awards, including options to purchase shares of common stock, stock purchase rights and RSUs to certain employees, officers, directors and consultants.

Our 2012 Equity Incentive Plan, or 2012 Plan, provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, RSUs, performance-based stock awards and other forms of equity compensation, or collectively, stock awards. In addition, the 2012 Plan provides for the grant of performance cash awards. Incentive stock options may be granted only to employees. All other awards may be granted to employees, including officers, as well as directors and consultants. The share reserve may increase to the extent outstanding stock options under the 2005 Plan expire or terminate unexercised. The share reserve also automatically increases on January 1 of each year until January 1, 2022, by up to 5% of the total number of shares of common stock outstanding on December 31 of the preceding year as determined by the board of directors. On January 1, 2016, 8,039,288 shares of common stock were automatically added to the 2012 Plan pursuant to the provision described in the preceding sentence.

Our 2012 Employee Stock Purchase Plan, or 2012 ESPP, authorizes the issuance of shares of common stock pursuant to purchase rights granted to our employees. The price at which common stock is purchased under the 2012 ESPP is equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. Offering periods are six months long and begin on February 1 and August 1 of each year. The number of shares of common stock reserved for issuance automatically increases on January 1 of each year until January 1, 2022, by up to 1% of the total number of shares of common stock outstanding on December 31 of the preceding year as determined by the board of directors. On January 1, 2016, 1,607,858 shares of common stock were automatically added to the 2012 ESPP pursuant to the provision described in the preceding sentence.





**Stock Options**

A summary of the stock option activity for the nine months ended September 30, 2016 is as follows:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	8,255,554	\$ 16.65		
Granted	169,400	65.92		
Exercised	(579,504 )	5.28		\$ 35,876
Canceled	(126,735 )	58.05		
Outstanding at March 31, 2016	7,718,715	17.90		
Granted	131,835	68.36		
Exercised	(828,327 )	17.18		\$ 43,757
Canceled	(119,321 )	52.26		
Outstanding at June 30, 2016	6,902,902	18.36		
Granted	232,750	74.47		
Exercised	(477,802 )	15.69		\$ 28,345
Canceled	(182,302 )	58.41		
Outstanding at September 30, 2016	6,475,548	\$ 19.44	5.54	\$ 386,791
Vested and expected to vest as of September 30, 2016	6,370,923	\$ 18.62	5.48	\$ 385,785
Vested and exercisable as of September 30, 2016	5,548,381	\$ 11.91	5.01	\$ 373,084

Aggregate intrinsic value represents the difference between the estimated fair value of our common stock and the exercise price of outstanding, in-the-money options. The weighted-average grant date fair value per share of options granted was \$27.90 for the nine months ended September 30, 2016. The total fair value of stock options vested during the nine months ended September 30, 2016 was \$14.2 million.

As of September 30, 2016, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options was approximately \$20.7 million. The weighted-average remaining vesting period of unvested stock options at September 30, 2016 was 2.83 years.

**RSUs**

A summary of RSU activity for the nine months ended September 30, 2016 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value (Per Share)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	12,417,805	\$63.38	
Granted	3,822,832	51.11	
Vested	(1,708,179 )	58.42	\$89,516
Forfeited	(370,545 )	64.43	
Outstanding at March 31, 2016	14,161,913	60.64	
Granted	805,680	67.75	
Vested	(1,285,704 )	53.70	\$86,693
Forfeited	(407,451 )	63.31	
Outstanding at June 30, 2016	13,274,438	61.66	
Granted	1,423,601	74.62	
Vested	(1,132,142 )	63.56	\$85,816
Forfeited	(731,573 )	61.29	
Non-vested and outstanding at September 30, 2016	12,834,324	\$62.95	\$1,015,837
Expected to vest as of September 30, 2016	10,843,628		\$858,273

RSUs granted to employees under the 2005 Plan and the 2012 Plan generally vest over a four-year period. As of September 30, 2016, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested RSUs was approximately \$603.8 million and the weighted-average remaining vesting period was 2.84 years.

**(13) Net Loss Per Share**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator:				
Net loss	\$(36,258 )	\$(41,030 )	\$(419,215 )	\$(161,048 )
Denominator:				
Weighted-average shares outstanding—basic and diluted	165,378,834	156,930,506	163,767,329	154,352,037
Net loss per share—basic and diluted:	\$(0.22 )	\$(0.26 )	\$(2.56 )	\$(1.04 )

Potentially dilutive securities that are not included in the calculation of diluted net loss per share because doing so would be antidilutive are as follows:

	September 30,	
	2016	2015
Common stock options	6,475,548	10,235,318
Restricted stock units	12,834,324	12,716,479
ESPP obligations	360,536	270,426
Convertible senior notes	7,783,023	7,783,023
Warrants related to the issuance of convertible senior notes	7,783,023	7,783,023
Total potentially dilutive securities	35,236,454	38,788,269

#### **(14) Income Taxes**

We compute our provision for income taxes by applying the estimated annual effective tax rate to year-to-date income (loss) from recurring operations and adjust the provision for discrete tax items recorded in the period.

Our effective tax rate was (9)% and 0% for the three and nine months ended September 30, 2016, respectively, which was lower than the U.S. federal statutory tax rate of 34%. The lower tax rate was primarily attributable to our loss from operations, the foreign tax rate differential, a release of the valuation allowance in connection with acquisitions, and tax effects of stock option excess tax benefits from the early adoption of ASU 2016-09.

Our effective tax rate was (3)% and (2)% for the three and nine months ended September 30, 2015, respectively, which was lower than the U.S. federal statutory tax rate of 34%. The lower tax rate was primarily attributable to our loss from operations, the foreign tax rate differential, non-deductible expenses arising from stock-based compensation, and the tax effects of unrealized gains in investment securities.

As described in Note 2 "Summary of Significant Accounting Policies," we adopted ASU 2016-09 in the quarter ended June 30, 2016. See Note 2 for further discussion.

We are subject to taxation in the United States and foreign jurisdictions. As of September 30, 2016, our tax years 2005 to 2015 remain subject to examination in most jurisdictions.

There are differing interpretations of tax laws and regulations, and as a result, disputes may arise with tax authorities involving issues of the timing and amount of deductions and allocations of income among various tax jurisdictions. We periodically evaluate our exposures associated with our tax filing positions. We believe that adequate amounts have been reserved for any adjustments that may ultimately result from these examinations, and we do not anticipate a significant impact to our gross unrecognized tax benefits within the next 12 months related to these years. Although the timing of the resolution, settlement, and closure of any audit is highly uncertain, it is possible that the balance of gross unrecognized tax benefits could significantly change in the next 12 months. However, given the number of years that remain subject to examination, we are unable to estimate the full range of possible adjustments to the balance of gross unrecognized tax benefits.

#### **(15) Commitments and Contingencies**

##### ***Leases***

We lease facilities for data center capacity and office space under non-cancelable operating lease agreements with various expiration dates.

***Legal Proceedings***

From time to time, we are party to litigation and other legal proceedings in the ordinary course of business. While the results of any litigation or other legal proceedings are uncertain, management does not believe the ultimate resolution of any pending legal matters is likely to have a material adverse effect on our financial position, results of operations or cash flows, except as discussed below and for those matters for which we have recorded a loss contingency. We accrue for loss contingencies when it is both probable that we will incur the loss and when we can reasonably estimate the amount of the loss or range of loss.

Generally, our subscription agreements require us to defend our customers for third-party intellectual property infringement and other claims. Any adverse determination related to intellectual property claims or other litigation could prevent us from offering our services and adversely affect our financial condition and results of operations.

On February 6, 2014, Hewlett-Packard Company (Hewlett-Packard) filed a lawsuit against us in the U.S. District Court for the Northern District of California. The lawsuit alleged patent infringement and sought damages and an injunction. On or about November 1, 2015, Hewlett Packard Enterprise Company (HPE) separated from Hewlett-Packard as an independent company, and Hewlett-Packard assigned to HPE all right, title, and interest in the eight Hewlett-Packard patents in the lawsuit and HPE was substituted as plaintiff in the litigation. On March 4, 2016, we entered into a confidential settlement agreement resolving the lawsuit with HPE (HPE Settlement). As a result, on March 9, 2016, the lawsuit was dismissed.

BMC Software, Inc. (BMC) filed lawsuits against us in the U.S. District Court for the Eastern District of Texas on September 23, 2014 and February 12, 2016, and in the Dusseldorf (Germany) Regional Court, Patent Division, on March 2, 2016. Each of the lawsuits alleged patent infringement and sought damages and an injunction. On April 8, 2016, we entered into a confidential settlement agreement resolving all the lawsuits with BMC (BMC Settlement). As a result, the second Texas lawsuit was dismissed on April 14, 2016, and each of the initial Texas lawsuit and the German lawsuit was dismissed on April 25, 2016.

These settlements are considered multiple element arrangements for accounting purposes. We evaluated the accounting treatment of these settlements by identifying each element of the arrangements, which included amongst other elements, a release of past infringement claims and a covenant not to sue for a specified term of years. The primary benefit we received from the arrangements was the settlement and termination of all existing litigation, the avoidance of future litigation expenses and the avoidance of future management and customer disruptions. We determined that none of the elements of the settlement agreements have identifiable future benefits that would be capitalized as an asset. Accordingly, we recorded charges for aggregate legal settlements of \$270.0 million in our condensed consolidated statement of comprehensive loss for the nine months ended September 30, 2016. The charge covers the fulfillment by us of all financial obligations under both the BMC Settlement and HPE Settlement with no remaining financial obligations under either settlement.

Apart from the \$267.5 million cash paid for aggregate legal settlements during the nine months ended September 30, 2016, there have been no material changes in our commitments under contractual obligations, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

## (16) Information about Geographic Areas and Products

Revenues by geographic area, based on the location of our users, were as follows for the periods presented (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
North America <sup>(1)</sup>	\$239,585	\$181,293	\$684,111	\$504,326
EMEA <sup>(2)</sup>	90,399	61,663	246,745	165,996
Asia Pacific and other	27,672	18,194	73,991	49,508
Total revenues	\$357,656	\$261,150	\$1,004,847	\$719,830

Property and equipment, net by geographic area were as follows (in thousands):

	September	December
	30,	31,
	2016	2015

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North America <sup>(3)</sup>	\$ 128,649	\$ 104,085
EMEA <sup>(2)</sup>	35,618	32,027
Asia Pacific and other	11,839	8,602
Total property and equipment, net	\$ 176,106	\$ 144,714

(1) Revenues attributed to the United States were approximately 95% of North America revenues for each of the three months ended September 30, 2016 and 2015 and nine months ended September 30, 2016 and 2015.

(2) Europe, the Middle East and Africa

(3) Property and equipment, net attributed to the United States were approximately 92% and 98% of property and equipment, net attributable to North America as of September 30, 2016 and December 31, 2015, respectively.

Subscription revenues consist of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Enterprise Service Management solutions	\$290,005	\$205,795	\$800,534	\$559,080
IT Operations Management solutions	28,929	17,413	76,501	44,496
Total subscription revenues	\$318,934	\$223,208	\$877,035	\$603,576

Our Enterprise Service Management solutions include Service Management, Business Management and ServiceNow Platform, which have similar features and functions, and are generally priced on a per user basis. Our IT Operations Management solutions, which improve visibility, availability and agility of enterprise services, are generally priced on a per node basis.

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

*The following discussion and analysis of our financial condition, results of operations and cash flows 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, 2015 included in the Annual Report on Form 10-K dated as of, and filed with the Securities and Exchange Commission, or the SEC, on February 25, 2016 (File No. 001-35580). 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, or 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 expressions or 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 the 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 Quarterly Report on Form 10-Q and in our other SEC filings. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.*

*The billing amounts, as described in the section entitled "—Key Factors Affecting Our Performance—Billings," as well as our free cash flow measure included in the section entitled "—Key Factors Affecting Our Performance—Free Cash Flow," are not in accordance with U.S. Generally Accepted Accounting Principles, or GAAP. These non-GAAP financial measures are not intended to be considered in isolation or as a substitute for, or superior to, financial information prepared and presented in accordance with GAAP. These measures may be different from non-GAAP financial measures used by other companies, limiting their usefulness for comparison purposes. We believe investors should consider these non-GAAP financial measures in evaluating our results as they are indicative of our ongoing performance and reflect how management evaluates our operational results and trends.*

### Overview

ServiceNow is a leading provider of enterprise cloud computing solutions that define, structure, manage and automate services across the global enterprise. Our mission is to help the modern enterprise operate faster and be more scalable by applying a service-oriented lens to the activities, tasks and processes that comprise day-to-day work life. We offer our services on an annual subscription fee basis which includes access to the ordered subscription service and related

support including updates to the subscribed service during the subscription term. We provide a scaled pricing model based on the duration of the subscription term and we frequently extend discounts to our customers based on the number of users. We generate sales through our direct sales team and, to a lesser extent, indirectly through channel partners and third-party referrals. We also generate revenues from professional services for implementation and training of customer personnel. We generally bill our customers annually in advance for subscription services and monthly in arrears for our professional services as the work is performed.

A majority of our revenues come from large global enterprise customers. We continue to invest in the development of our services, infrastructure and sales and marketing to drive long-term growth. We increased our overall employee headcount to 4,501 as of September 30, 2016 from 3,402 as of September 30, 2015.



## Key Factors Affecting Our Performance

*Number of customers with ACV greater than \$1 million.* We count the total number of customers with annualized contract value, or ACV, greater than \$1 million as of the end of the period. We had 301 and 203 customers with ACV greater than \$1 million as of September 30, 2016 and 2015, respectively. For purposes of customer count, a customer is defined as an entity with a unique Dunn & Bradstreet Global Ultimate, or GULT, Data Universal Numbering System, or DUNS, and an active subscription contract as of the measurement date. The DUNS number is a global standard for business identification and tracking. We make exceptions for holding companies, government entities and other organizations for which the GULT, in our judgment, does not accurately represent the ServiceNow customer. For example, while all U.S. government agencies roll up to "Government of the United States" under the GULT, we count each government agency that we contract with as a separate customer. Our customer count is subject to adjustments for acquisitions, spin-offs and other market activity. Previously disclosed number of customers with ACV greater than \$1 million as well as our average contract term calculations are restated to allow for comparability.

*G2K customer count.* The Global 2000, or G2K, customer count is defined as the total number of G2K companies in our customer base as of the end of the period. The Forbes Global 2000 is an annual ranking of the top 2000 public companies in the world by Forbes magazine. The ranking is based on a mix of four metrics: sales, profit, assets, and market value. The Forbes Global 2000 is updated annually in the second quarter of the calendar year. Current and prior period G2K customer counts are based on the most recent list for comparability purposes. We adjust the G2K count for acquisitions, spin-offs and other market activity to ensure the G2K customer count is accurately captured. For example, we add a G2K customer when a G2K company that is not our customer acquires a company in our existing customer base that is not a G2K company. When we enter into a contract with a G2K parent company, or any of its related subsidiaries, or any combination of entities within a G2K company, we count only one G2K customer. We do not count further penetration into entities within a given G2K as a new customer in the G2K customer count. Our G2K customer count also excludes customers that have only purchased our Express product offering, which is our entry-level IT service management solution.

Our G2K customer count was 705 and 607 as of September 30, 2016 and 2015, respectively.

*Average ACV per G2K customer.* We calculate average ACV for our G2K customers by taking cumulative ACV from G2K customers as of the end of the period divided by cumulative count of G2K customers as of the end of the period. Our average ACV per G2K customer was approximately \$997,000 and \$828,000 as of September 30, 2016 and 2015, respectively.

*Renewal rate.* We calculate our renewal rate by subtracting our attrition rate from 100%. Our attrition rate for a period is equal to the ACV from lost customers, divided by the total ACV from all customers that renewed during the period, excluding changes in price or users, and total ACV from all lost customers. A lost customer is a customer that did not renew an expiring contract and that, in our judgment, will not be renewed. Typically, a customer that reduces its subscription upon renewal is not considered a lost customer. However, in instances where the subscription decrease represents the majority of the customer's ACV, we may deem the renewal as a lost customer. For our renewal rate calculation, we define a customer as an entity with a separate production instance of our service and an active subscription contract as of the measurement date, instead of an entity with a unique GULT or DUNS number. Our renewal rate was 99% and 98% for the three months ended September 30, 2016 and 2015, respectively, and 98% and 97% for the nine months ended September 30, 2016 and 2015, respectively.

*Billings.* We define billings as revenue recognized plus the change in total deferred revenue as presented on the condensed consolidated statements of cash flows. The change in total deferred revenue as presented on the condensed consolidated statements of cash flows represent the change in deferred revenues in local currencies translated into U.S. dollars using an average foreign currency exchange rate, and aligns actual billings with the exchange rates in effect at

the time of the billings. We believe billings offers investors useful supplemental information regarding the performance of our business and will help investors better understand the sales volume and performance of our business.

A calculation of billings is provided below:

	Three Months Ended September 30,		% Change	Nine Months Ended September 30,		% Change
	2016	2015		2016	2015	
	(dollars in thousands)			(dollars in thousands)		
Billings:						
Total revenues	\$357,656	\$261,150	37 %	\$1,004,847	\$719,830	40 %
Change in deferred revenue from the condensed consolidated statements of cash flows	46,620	25,255	85 %	151,019	115,812	30 %
Total billings	\$404,276	\$286,405	41 %	\$1,155,866	\$835,642	38 %

*Free cash flow.* We define free cash flow, a non-GAAP financial measure, as GAAP net cash provided by operating activities reduced by purchases of property and equipment. We believe information regarding free cash flow provides useful information to investors because it is an indicator of the strength and performance of ongoing business operations. However, our calculation of free cash flow may not be comparable to similar measures used by other companies. A calculation of free cash flow is provided below:

	Nine Months Ended September 30,		% Change
	2016	2015	
	(dollars in thousands)		
Free cash flow:			
Net cash provided by operating activities	\$27,234	\$211,200	(87)%
Purchases of property and equipment	(84,112)	(62,588)	34 %
Free cash flow <sup>(1)</sup>	\$(56,878)	\$148,612	(138)%

(1) Free cash flow includes the effect of a \$267.5 million payment for aggregate legal settlements for the nine months ended September 30, 2016. Refer to Note 15 in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for further details.

*Average contract term.* We calculate the average contract term for new customers, upsells and renewals based on the term of those contracts entered into during the period weighted by their ACV. The average new customer contract term was 31 months for each of the three and nine months ended September 30, 2016 and 2015. The average upsell contract term was 25 months for each of the three and nine months ended September 30, 2016, and 28 months and 25 months for the three and nine months ended September 30, 2015, respectively. The average renewal contract term was 27 months for each of the three and nine months ended September 30, 2016 and 25 months for each of the three and nine months ended September 30, 2015.

## Components of Results of Operations

### Revenues

*Subscription revenues.* Subscription revenues are primarily comprised of fees that give customers access to the ordered subscription service, related support and upgrades, if any, to the subscribed service during the subscription term. Pricing includes multiple instances, hosting and support services, data backup and disaster recovery services, as well as future upgrades, when and if available, offered during the subscription term. We typically invoice our customers for subscription fees in annual increments upon execution of the initial contract or subsequent renewal. Our contracts are generally non-cancelable during the subscription term, though a customer can terminate for breach if we materially fail to perform.

*Professional services and other revenues.* Professional services revenues consist of fees associated with the implementation and configuration of our subscription service. Our arrangements for professional services are primarily on a time-and-materials basis. We generally invoice our professional services monthly in arrears based on actual hours and expenses incurred. Other revenues primarily include fees from customer training delivered on-site or publicly available classes, attendance and sponsorship fees for our annual Knowledge user conference and other customer forums. Typical payment terms require our customers to pay us within 30 days of invoice.

We generate sales directly through our sales team and, to a lesser extent, through our channel partners. Revenues from our direct sales organization represented 88% of our total revenues for each of the three and nine months ended September 30, 2016 and 89% of our total revenues for each of the three and nine months ended September 30, 2015. We make sales to our channel partners at a discount and record those revenues at the discounted price when all revenue recognition criteria are met. From time to time, our channel partners also provide us referrals for which we pay a referral fee. We pay referral fees to channel partners and other third parties, which are between 10% and 15% of the customer's ACV, depending on the level of activity the partner performs in the sales process. We include these fees in sales and marketing expense.

#### ***Allocation of Overhead Costs***

Overhead costs associated with office facilities, IT and certain depreciation related to infrastructure that is not dedicated for customer use or research and development use are allocated to cost of revenues and operating expenses based on headcount.

#### ***Cost of Revenues***

*Cost of subscription revenues.* Cost of subscription revenues consists primarily of expenses related to hosting our services and providing support to our customers. These expenses are comprised of data center capacity costs, which includes facility costs associated with our data center, depreciation related to our cloud-based infrastructure hardware equipment dedicated for customer use, amortization of acquired developed technology intangibles, and personnel related costs directly associated with our cloud-based infrastructure and customer support, including salaries, benefits, bonuses and stock-based compensation and allocated overhead.

*Cost of professional services and other revenues.* Cost of professional services and other revenues consists primarily of personnel related costs directly associated with our professional services and training departments, including salaries, benefits, bonuses and stock-based compensation, the costs of contracted third-party partners and allocated overhead.

Professional services associated with the implementation and configuration of our subscription services are performed directly by our services team, as well as by contracted third-party partners. Fees paid to third-party partners are primarily recognized as cost of revenues as the professional services are delivered. Cost of revenues associated with our professional services engagements contracted with third-party partners as a percentage of professional services and other revenues was 19% and 23% for the three months ended September 30, 2016 and 2015, respectively, and 18% and 19% for the nine months ended September 30, 2016 and 2015, respectively.

#### ***Sales and Marketing***

Sales and marketing expenses consist primarily of personnel related expenses directly associated with our sales and marketing staff, including salaries, benefits, bonuses, commissions and stock-based compensation. Sales and marketing expenses also include third-party referral fees, marketing and promotional events, including our annual Knowledge user conference, online marketing, product marketing and allocated overhead.

***Research and Development***

Research and development expenses consist primarily of personnel related expenses directly associated with our research and development staff, including salaries, benefits, bonuses and stock-based compensation and allocated overhead. Research and development expenses also include data center capacity costs and depreciation of cloud-based infrastructure hardware equipment that are used solely for research and development purposes.

***General and Administrative***

General and administrative expenses consist primarily of personnel related expenses for our executive, finance, legal, human resources, facility and administrative personnel, including salaries, benefits, bonuses and stock-based compensation, external legal, accounting and other professional services fees, other corporate expenses and allocated overhead.

### ***Legal Settlements***

Legal settlements consist of one-time aggregate charges related to the settlement agreements with Hewlett Packard Enterprise Company and BMC Software, Inc. Refer to Note 15 in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for further details of these matters.

### ***Provision for Income Taxes***

Provision for income taxes consists of federal, state and foreign income taxes. Due to cumulative losses, we maintain a valuation allowance against our U.S. deferred tax assets as of September 30, 2016 and December 31, 2015. We consider all available evidence, both positive and negative, including but not limited to earnings history, projected future outcomes, industry and market trends and the nature of each of the deferred tax assets in assessing the extent to which a valuation allowance should be applied against our U.S. deferred tax assets.

### ***New Accounting Pronouncements Adopted in 2016***

In March 2016, the FASB issued ASU 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This standard is effective for our interim and annual reporting periods beginning January 1, 2017, and early adoption is permitted. We elected to early adopt this standard in the quarter ended June 30, 2016. The impact of the early adoption was as follows:

The standard eliminates additional paid in capital (APIC) pools and requires excess tax benefits and tax deficiencies to be recorded in the income statement as a discrete item when the awards vest or are settled. The adoption of this guidance on a prospective basis resulted in the recognition of excess tax benefits in our provision for income taxes of \$0.3 million and \$2.0 million for the three and nine months ended September 30, 2016, respectively.

The standard requires excess tax benefits be recognized regardless of whether the benefit reduces taxes payable. The adoption of this guidance on a modified retrospective basis resulted in the recognition of a cumulative-effect adjustment of \$11.4 million that reduced our accumulated deficit and increased our foreign long-term deferred income tax as of January 1, 2016. The previously unrecognized domestic excess tax effects were recorded as a deferred tax asset net of a valuation allowance.

We have elected to continue to estimate forfeitures expected to occur to determine the amount of stock-based compensation cost to be recognized in each period. As such, the guidance relating to forfeitures did not have an impact on our accumulated deficit as of January 1, 2016.

We elected to apply the statement of cash flows guidance that cash flows related to excess tax benefits be presented as an operating activity retrospectively, which resulted in a \$1.2 million increase to net cash provided by operating activities and a corresponding decrease to net cash provided by financing activities in the accompanying condensed consolidated statement of cash flows for the nine months ended September 30, 2015, as compared to the amounts previously reported.

The statement of cash flows guidance that cash flows related to employee taxes paid for withheld shares be presented as a financing activity had no impact on our condensed consolidated financial statements as we have historically presented such cash flows as a financing activity.

In September 2015, the FASB issued ASU 2015-16, “Simplifying the Accounting for Measurement-Period Adjustments (Topic 805),” which eliminates the requirement to restate prior period financial statements for measurement period adjustments in business combinations. This new standard requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. We adopted this standard during the three months ended March 31, 2016 on a prospective basis and the adoption had no material impact on our condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes software. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. We adopted this standard during the three months ended March 31, 2016 on a prospective basis and the adoption had no material impact on our condensed consolidated financial statements.

### ***Pending Accounting Pronouncements***

In October 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory," which includes a revision of the accounting for the income tax consequences of intra-entity transfers of assets other than inventory to reduce the complexity in accounting standards. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017, and early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," which provides guidance on eight specific cash flow issues. Among these issues, this standard requires, at the settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowings, the portion of the cash payment attributable to the accreted interest related to the debt discount to be classified as cash flows for operating activities, and the portion of the cash payments attributable to the principal to be classified as cash outflows for financing activities. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017, and early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which requires a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This standard is effective for our interim and annual reporting periods beginning after December 15, 2019. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets, and to recognize on the income statement the expenses in a manner similar to current practice. This new standard is effective for our interim and annual periods beginning January 1, 2019 and early adoption is permitted. While we are currently evaluating the impact of this standard on our condensed consolidated financial statements, we anticipate this standard will have a material impact on our condensed consolidated balance sheets given that we have operating lease commitments of approximately \$300 million as of September 30, 2016. However, we do not anticipate this standard will have a material impact on our condensed consolidated statements of comprehensive loss since the expense recognition under this new standard will be similar to current practice.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This new standard is effective for our interim and annual periods beginning January 1, 2018 and early adoption is not permitted. We are currently evaluating the impact



of this standard on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which will supersede virtually all existing revenue guidance. Under this standard, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This standard should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in the retained earnings. In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the principal versus agent guidance in the new revenue recognition standard. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which clarifies the guidance on accounting for licenses of intellectual property (IP) and identifying performance obligations in the new revenue recognition standard. In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," which amended the revenue recognition guidance regarding collectability, non-cash consideration, presentation of sales tax and transition. These new standards are effective for our interim and annual periods beginning January 1, 2018 and early adoption beginning January 1, 2017 is permitted. We are currently evaluating the impact of these standards on our condensed consolidated financial statements and have not yet selected the transition method.

**Results of Operations**

To enhance comparability, the following table sets forth our results of operations for the periods presented. The period-to-period comparison of financial results is not necessarily indicative of future results.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Revenues:				
Subscription	\$ 318,934	\$ 223,208	\$ 877,035	\$ 603,576
Professional services and other	38,722	37,942	127,812	116,254
Total revenues	357,656	261,150	1,004,847	719,830
Cost of revenues <sup>(1)</sup> :				
Subscription	61,566	46,053	170,707	133,889
Professional services and other	41,271	35,835	123,039	104,615
Total cost of revenues	102,837	81,888	293,746	238,504
Gross profit	254,819	179,262	711,101	481,326
Operating expenses <sup>(1)</sup> :				
Sales and marketing	166,491	117,899	511,607	364,530
Research and development	75,018	55,822	211,306	158,946
General and administrative	40,085	33,581	117,393	93,357
Legal settlements	—	—	270,000	—
Total operating expenses	281,594	207,302	1,110,306	616,833
Loss from operations	(26,775 )	(28,040 )	(399,205 )	(135,507 )
Interest expense	(8,389 )	(7,839 )	(24,746 )	(23,124 )
Interest income and other income (expense), net	1,783	(3,952 )	4,745	1,273
Loss before income taxes	(33,381 )	(39,831 )	(419,206 )	(157,358 )
Provision for income taxes	2,877	1,199	9	3,690
Net loss	\$(36,258 )	\$(41,030 )	\$(419,215 )	\$(161,048 )

(1) Stock-based compensation included in the statements of operations above was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Cost of revenues:				
Subscription	\$ 7,140	\$ 5,951	\$ 20,698	\$ 17,183
Professional services and other	7,150	5,804	20,045	16,788
Sales and marketing	31,898	26,011	95,757	74,690
Research and development	21,376	18,130	62,956	51,703
General and administrative	13,523	9,215	35,004	29,167
Total stock-based compensation	\$ 81,087	\$ 65,111	\$ 234,460	\$ 189,531

The following table sets forth our results of operations as a percentage of total revenues for the periods presented.

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Revenues:				
Subscription	89 %	85 %	87 %	84 %
Professional services and other	11	15	13	16
Total revenues	100	100	100	100
Cost of revenues <sup>(1)</sup> :				
Subscription	17	18	17	19
Professional services and other	12	14	12	15
Total cost of revenues	29	32	29	34
Gross profit	71	68	71	66
Operating expenses <sup>(1)</sup> :				
Sales and marketing	47	45	51	51
Research and development	21	21	21	22
General and administrative	11	13	12	13
Legal settlements	—	—	27	—
Total operating expenses	79	79	111	86
Loss from operations	(8 )	(11 )	(40 )	(19 )
Interest expense	(2 )	(3 )	(2 )	(2 )
Interest income and other income (expense), net	1	(2 )	—	—
Loss before income taxes	(9 )	(16 )	(42 )	(21 )
Provision for income taxes	1	—	—	1
Net loss	(10 )%	(16 )%	(42 )%	(22 )%

(1) Stock-based compensation included in the statements of operations above as a percentage of revenues was as follows:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Cost of revenues:				
Subscription	2 %	2 %	2 %	2 %
Professional services and other	2	2	2	2
Sales and marketing	9	10	10	10
Research and development	6	7	6	7
General and administrative	4	4	3	5
Total stock-based compensation	23 %	25 %	23 %	26 %

**Comparison of the Three Months Ended September 30, 2016 and 2015****Revenues**

	Three Months Ended September 30,		% Change	
	2016	2015		
	(dollars in thousands)			
Revenues:				
Subscription	\$318,934	\$223,208	43	%
Professional services and other	38,722	37,942	2	%
Total revenues	\$357,656	\$261,150	37	%
Percentage of revenues:				
Subscription	89	% 85	%	
Professional services and other	11	% 15	%	
Total	100	% 100	%	

Subscription revenues increased \$95.7 million during the three months ended September 30, 2016, compared to the same period in the prior year, driven by our upsells and an increase in our customer count.

Subscription revenues consist of the following:

	Three Months Ended September 30,		% Change	
	2016	2015		
	(dollars in thousands)			
Enterprise Service Management solutions	\$290,005	\$205,795	41	%
IT Operations Management solutions	28,929	17,413	66	%
Total subscription revenues	\$318,934	\$223,208	43	%

Our Enterprise Service Management solutions include Service Management, Business Management and ServiceNow Platform, which have similar features and functions and are generally priced on a per user basis. Our IT Operations Management solutions, which improve visibility, availability and agility of enterprise services, are generally priced on a per node basis. We expect subscription revenues for both our Enterprise Service Management solutions and IT Operations Management solutions to grow in absolute dollar terms and for IT Operations Management solutions to grow as a percentage of total subscription revenues for the year ended December 31, 2016 compared to the year ended December 31, 2015.

Professional services and other revenues increased \$0.8 million during the three months ended September 30, 2016, compared to the same period in the prior year, due to an increase in the services provided to our growing customer base. We expect professional services and other revenues to increase in absolute dollar terms, but at a slower rate than subscription revenues for the year ended December 31, 2016 compared to the year ended December 31, 2015, as we are increasingly focused on deploying our internal professional services organization as a strategic resource and relying on our partner ecosystem to contract directly with customers for service delivery.

**Cost of Revenues and Gross Profit Percentage**

	Three Months Ended September		% Change	
	30, 2016	2015		
(dollars in thousands)				
Cost of revenues:				
Subscription	\$61,566	\$46,053	34	%
Professional services and other	41,271	35,835	15	%
Total cost of revenues	\$102,837	\$81,888	26	%
Gross profit percentage:				
Subscription	81	% 79	%	
Professional services and other	(7	)% 6	%	
Total gross profit percentage	71	% 68	%	
Gross Profit	\$254,819	\$179,262		
Headcount (at period end)				
Subscription	691	543	27	%
Professional services and other	504	453	11	%
Total headcount	1,195	996	20	%

Cost of subscription revenues increased \$15.5 million during the three months ended September 30, 2016, compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of \$4.9 million in personnel related costs excluding stock-based compensation, an increase of \$2.3 million in overhead expenses and an increase of \$1.2 million in stock-based compensation. In addition, there was an increase of \$3.3 million in depreciation expense primarily due to purchases of cloud-based infrastructure hardware equipment for our data centers, an increase of \$1.5 million in data center capacity costs due to the expansion of our data centers and an increase of \$0.7 million in amortization of intangibles.

Our subscription gross profit percentage increased to 81% for the three months ended September 30, 2016, from 79% for the three months ended September 30, 2015, due to data center density and improved economies of scale. We expect our cost of subscription revenues to increase in absolute dollar terms for the year ended December 31, 2016 compared to the year ended December 31, 2015 as we provide subscription services to more customers and increase the number of users within our customer instances. We expect our subscription gross profit percentage to improve for the year ended December 31, 2016 compared to the year ended December 31, 2015 as we continue to leverage the investments we have made in our existing data center infrastructure. To the extent future acquisitions are consummated, our cost of subscription revenues may increase due to additional non-cash charges associated with the amortization of intangible assets acquired.

Cost of professional services and other revenues increased \$5.4 million during the three months ended September 30, 2016 as compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of \$2.8 million in personnel related costs excluding stock-based compensation, an increase of \$1.3 million in stock-based compensation, and an increase of \$1.2 million in overhead expenses.

Our professional services and other gross profit percentage decreased to (7)% for the three months ended September 30, 2016, from 6% for the three months ended September 30, 2015, due to lower utilization rates as we invest in specialized resources to support our newer products and higher growth rate in our stock-based compensation of 23% compared to the growth rate in our professional services and other revenues of 2%.



**Sales and Marketing**

	Three Months Ended September 30,		% Change	
	2016	2015		
	(dollars in thousands)			
Sales and marketing	\$ 166,491	\$ 117,899	41	%
Percentage of revenues	47	% 45	%	
Headcount (at period end)	1,740	1,254	39	%

Sales and marketing expenses increased \$48.6 million during the three months ended September 30, 2016 compared to the same period in the prior year, primarily due to increased headcount that resulted in an increase of \$27.4 million in personnel related costs excluding stock-based compensation, an increase of \$5.9 million in stock-based compensation, an increase of \$6.5 million in overhead expenses and an increase of \$4.1 million in commissions expense. Commissions and referral fees amounted to 7% and 8% of subscription revenues for three months ended September 30, 2016 and 2015, respectively. Marketing program expenses, which include events, advertising and market data, increased \$2.9 million during the three months ended September 30, 2016 compared to the same period in the prior year. Outside services increased \$1.5 million during the three months ended September 30, 2016 compared to the same period in the prior year, primarily due to an increase in contractors and professional fees to support our sales and marketing functions.

We expect sales and marketing expenses to increase in absolute dollar terms for the year ended December 31, 2016 compared to the year ended December 31, 2015 as we continue to expand our direct sales force, increase our marketing activities, grow our international operations, build brand awareness and sponsor additional marketing events, but remain relatively flat as a percentage of total revenues.

**Research and Development**

	Three Months Ended September 30,		% Change	
	2016	2015		
	(dollars in thousands)			
Research and development	\$75,018	\$55,822	34	%
Percentage of revenues	21	% 21	%	
Headcount (at period end)	970	731	33	%

Research and development expenses increased \$19.2 million during the three months ended September 30, 2016 compared to the same period in the prior year, primarily due to increased headcount, which resulted in an increase of \$10.4 million in personnel related costs excluding stock-based compensation, an increase of \$3.2 million in stock-based compensation and an increase of \$2.8 million in overhead expenses. Outside services increased \$1.2 million during the three months ended September 30, 2016 compared to the same period in the prior year, primarily due to an increase in contractors and professional fees to support our research and development functions. Research and development expenses also increased \$0.9 million due to an increase in data center capacity costs and depreciation of cloud-based infrastructure hardware equipment used solely for research and development purposes.

We expect research and development expenses to increase in absolute dollar terms, but decrease slightly as a percentage of total revenues for the year ended December 31, 2016 compared to the year ended December 31, 2015.



**General and Administrative**

	Three Months Ended September 30,		% Change	
	2016	2015		
	(dollars in thousands)			
General and administrative	\$40,085	\$33,581	19	%
Percentage of revenues	11	% 13		%
Headcount (at period end)	596	421	42	%

General and administrative expenses increased \$6.5 million during the three months ended September 30, 2016, compared to the same period in the prior year, primarily due to increased headcount, which resulted in an increase of \$2.8 million in personnel related costs excluding stock-based compensation, an increase of \$4.3 million in stock-based compensation and an increase of \$1.8 million in overhead expenses, partially offset by a decrease of \$2.7 million in outside services primarily due to a decrease in attorney fees associated with litigations.

We expect general and administrative expenses to increase in absolute dollar terms but decrease slightly as a percentage of total revenues for the year ended December 31, 2016 compared to the year ended December 31, 2015 as we continue to grow.

**Stock-based Compensation**

	Three Months Ended September 30,		% Change	
	2016	2015		
	(dollars in thousands)			
Cost of revenues:				
Subscription	\$7,140	\$5,951	20	%
Professional services and other	7,150	5,804	23	%
Sales and marketing	31,898	26,011	23	%
Research and development	21,376	18,130	18	%
General and administrative	13,523	9,215	47	%
Total stock-based compensation	\$81,087	\$65,111	25	%
Percentage of revenues	23	% 25		%

Stock-based compensation increased \$16.0 million during the three months ended September 30, 2016, compared to the same period in the prior year, primarily due to equity grants to new employees and additional grants to current employees.

Based upon our stock price as of September 30, 2016, we expect stock-based compensation to continue to remain relatively flat for the remainder of the year in absolute dollar terms and decrease as a percentage of total revenues. Stock-based compensation is inherently difficult to forecast due to fluctuations in our stock price.

**Interest Expense**

	Three Months Ended September 30,		% Change	
	2016	2015		
	(dollars in thousands)			
Interest expense	\$8,389	\$7,839	7	%
Percentage of revenues	2	% 3		%

Interest expense increased \$0.6 million during the three months ended September 30, 2016 compared to the same period in the prior year, due to the increase in amortization expense of debt discount and issuance costs related to the Notes. For the remainder of the year, we expect to incur approximately \$8.5 million in amortization expense of debt discount and issuance costs related to the Notes.

***Interest Income and Other Income (Expense), net***

	Three Months Ended September 30,		% Change
	2016	2015	
	(dollars in thousands)		
Interest income	\$2,049	\$1,252	64 %
Foreign currency exchange loss	(303 )	(5,063 )	(94 )%
Other	37	(141 )	NM
Interest and other income (expense), net	\$1,783	\$(3,952)	NM
Percentage of revenues	1 %	(2 )%	

Interest income and other income (expense), net, increased \$5.7 million during the three months ended September 30, 2016 compared to the same period in the prior year, primarily due to lower foreign exchange losses and increased interest income. We had foreign exchange losses of \$0.3 million for the three months ended September 30, 2016 compared to losses of \$5.1 million for the three months ended September 30, 2015 as a result of fluctuations in foreign currency exchange rates. Interest income increased \$0.8 million due to higher yields on our invested balances for the three months ended September 30, 2016.

Our expanding international operations will continue to increase our exposure to currency risks, though we cannot presently predict the impact of this exposure on our condensed consolidated financial statements. While we have not engaged in the hedging of our foreign currency transactions to date, we are conducting an ongoing evaluation of the costs and benefits of initiating such a program and in the future may hedge selected significant transactions denominated in currencies other than the U.S. Dollar.

***Provision for Income Taxes***

	Three Months Ended September 30,		% Change
	2016	2015	
	(dollars in thousands)		
Loss before income taxes	\$(33,381)	\$(39,831)	(16 )%
Provision for income taxes	2,877	1,199	140 %
Effective tax rate	(9 )%	(3 )%	

Our effective tax rate changed to (9)% for the three months ended September 30, 2016 compared to (3)% for the three months ended September 30, 2015 primarily due to our loss from operations, the foreign tax rate differential and the adjustment to our deferred tax assets due to foreign rate change.

We continue to maintain a full valuation allowance on our U.S. federal and state deferred tax assets, and the significant components of the tax expense recorded are current cash taxes in various jurisdictions. The cash tax expenses are impacted by each jurisdiction's individual tax rates, laws on timing of recognition of income and deductions, and availability of net operating losses and tax credits. Given the full valuation allowance, sensitivity of current cash taxes to local rules and our foreign restructuring, we expect that our effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected to the extent earnings are lower than anticipated in countries that have lower statutory rates and higher than anticipated in countries that have higher statutory rates. We consider the earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States.



**Net Loss**

	Three Months Ended September		% Change
	30, 2016	2015	
	(dollars in thousands)		
Net loss	\$ (36,258)	\$ (41,030)	(12 )%
Percentage of revenues	(10 )%	(16 )%	

Net loss decreased \$4.8 million during the three months ended September 30, 2016 compared to the same period in the prior year as our revenue growth exceeded our growth in expenses. We expect to continue to incur a GAAP loss for the remainder of the year due to increased costs and expenses including non-cash charges associated with equity awards, amortization of purchased intangibles from business combinations and other expenses.

**Comparison of the Nine Months Ended September 30, 2016 and 2015****Revenues**

	Nine Months Ended September		% Change
	30, 2016	2015	
	(dollars in thousands)		
Revenues:			
Subscription	\$ 877,035	\$ 603,576	45 %
Professional services and other	127,812	116,254	10 %
Total revenues	\$ 1,004,847	\$ 719,830	40 %
Percentage of revenues:			
Subscription	87	% 84	%
Professional services and other	13	% 16	%
Total	100	% 100	%

Subscription revenues increased \$273.5 million during the nine months ended September 30, 2016, compared to the same period in the prior year, driven by our upsells and an increase in our customer count.

Subscription revenues consist of the following:

	Nine Months Ended		% Change
	September 30, 2016	2015	
	(dollars in thousands)		
Enterprise Service Management solutions	\$ 800,534	\$ 559,080	43 %
IT Operations Management solutions	76,501	44,496	72 %
Total subscription revenues	\$ 877,035	\$ 603,576	45 %

Our Enterprise Service Management solutions include Service Management, Business Management and ServiceNow Platform, which have similar features and functions and are generally priced on a per user basis. Our IT Operations Management solutions, which improve visibility, availability and agility of enterprise services, are generally priced on a per node basis.

Professional services and other revenues increased \$11.6 million during the nine months ended September 30, 2016, compared to the same period in the prior year, due to an increase in the services provided to our growing customer base. Included within our total professional services and other revenues are the revenues from our annual Knowledge

user conference which increased to \$12.8 million for the nine months ended September 30, 2016 from \$10.9 million for the nine months ended September 30, 2015 due to increased sponsorship and paid registration in the current year.

**Cost of Revenues and Gross Profit Percentage**

	Nine Months Ended September		% Change	
	30, 2016	2015		
(dollars in thousands)				
Cost of revenues:				
Subscription	\$ 170,707	\$ 133,889	27	%
Professional services and other	123,039	104,615	18	%
Total cost of revenues	\$ 293,746	\$ 238,504	23	%
Gross profit percentage:				
Subscription	81	% 78		%
Professional services and other	4	% 10		%
Total gross profit percentage	71	% 66		%
Gross Profit	\$ 711,101	\$ 481,326		
Headcount (at period end)				
Subscription	691	543	27	%
Professional services and other	504	453	11	%
Total headcount	1,195	996	20	%

Cost of subscription revenues increased \$36.8 million during the nine months ended September 30, 2016, compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of \$12.1 million in personnel related costs excluding stock-based compensation, an increase of \$5.9 million in overhead expenses and an increase of \$3.5 million in stock-based compensation. In addition, there was an increase of \$6.7 million in depreciation expense primarily due to purchases of cloud-based infrastructure hardware equipment for our data centers, an increase of \$4.3 million in data center capacity costs due to the expansion of our data centers and an increase of \$1.0 million in amortization of intangibles.

Our subscription gross profit percentage increased to 81% for the nine months ended September 30, 2016, from 78% for the nine months ended September 30, 2015, due to data center density and improved economies of scale.

Cost of professional services and other revenues increased \$18.4 million during the nine months ended September 30, 2016 as compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of \$7.6 million in personnel related costs excluding stock-based compensation, an increase of \$3.3 million in stock-based compensation, an increase of \$3.3 million in overhead expenses and an increase of \$2.6 million in contracted third-party partner costs.

Our professional services and other gross profit percentage decreased to 4% for the nine months ended September 30, 2016, from 10% for the nine months ended September 30, 2015, due to lower utilization rates as we invest in specialized resources to support our newer products and higher growth rate in our stock-based compensation of 19% compared to the growth rate in our professional services and other revenues of 10%, partially offset by the increase in revenues from our annual Knowledge user conference. Costs associated with Knowledge are included in sales and marketing expenses. Knowledge contributed \$12.8 million to revenues, or 11 percentage points, to the professional services and other gross profit percentage for the nine months ended September 30, 2016. For the nine months ended September 30, 2015, Knowledge contributed \$10.9 million to revenues, and 9 percentage points to the professional services and other gross profit percentage.

**Sales and Marketing**

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	Nine Months Ended September			
	30,		% Change	
	2016	2015		
	(dollars in thousands)			
Sales and marketing	\$511,607	\$364,530	40	%
Percentage of revenues	51	% 51	%	
Headcount (at period end)	1,740	1,254	39	%

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Sales and marketing expenses increased \$147.1 million during the nine months ended September 30, 2016 compared to the same period in the prior year, primarily due to increased headcount that resulted in an increase of \$76.9 million in personnel related costs excluding stock-based compensation, an increase of \$21.1 million in stock-based compensation, an increase of \$18.9 million in overhead expenses and an increase of \$10.2 million in commissions expense. Commissions and referral fees amounted to 7% and 9% of subscription revenues for nine months ended September 30, 2016 and 2015, respectively. In addition, expenses related to our annual Knowledge user conference increased \$3.0 million, from \$21.0 million for the nine months ended September 30, 2015 to \$24.0 million for the nine months ended September 30, 2016, due to the number of attendees increasing by 31% year-over-year. All other marketing program expenses, which include events, advertising and market data, increased \$12.7 million during the nine months ended September 30, 2016 compared to the same period in the prior year.

### ***Research and Development***

	Nine Months Ended September		% Change	
	2016	2015		
	(dollars in thousands)			
Research and development	\$211,306	\$158,946	33	%
Percentage of revenues	21	% 22	%	
Headcount (at period end)	970	731	33	%

Research and development expenses increased \$52.4 million during the nine months ended September 30, 2016 compared to the same period in the prior year, primarily due to increased headcount, which resulted in an increase of \$28.0 million in personnel related costs excluding stock-based compensation, an increase of \$11.3 million in stock-based compensation and an increase of \$8.3 million in overhead expenses. Outside services increased \$1.7 million during the nine months ended September 30, 2016 compared to the same period in the prior year, primarily due to an increase in professional fees to support our research and development functions. Research and development expenses also increased \$2.1 million due to an increase in data center capacity costs and depreciation of cloud-based infrastructure hardware equipment used solely for research and development purposes.

### ***General and Administrative***

	Nine Months Ended		% Change	
	September 30, 2016	2015		
	(dollars in thousands)			
General and administrative	\$117,393	\$93,357	26	%
Percentage of revenues	12	% 13	%	
Headcount (at period end)	596	421	42	%

General and administrative expenses increased \$24.0 million during the nine months ended September 30, 2016, compared to the same period in the prior year, primarily due to increased headcount, which resulted in an increase of \$9.0 million in personnel related costs excluding stock-based compensation, an increase of \$5.8 million in stock-based compensation and an increase of \$4.8 million in overhead expenses. Outside services increased \$2.1 million due to an increase in contractors to support our administrative functions.

### ***Legal Settlements***

	Nine Months Ended		% Change	
	September 30, 2016	2015		

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(dollars in thousands)

Legal settlements	\$270,000	\$—	NM
Percentage of revenues	27	%	—%

Legal settlements increased \$270.0 million during the nine months ended September 30, 2016 compared to the same period in the prior year, related to the settlement agreements with HPE and BMC. Refer to Note 15 in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for further details of these matters.

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**Stock-based Compensation**

	Nine Months Ended September 30,		% Change	
	2016	2015		
(dollars in thousands)				
Cost of revenues:				
Subscription	\$20,698	\$17,183	20	%
Professional services and other	20,045	16,788	19	%
Sales and marketing	95,757	74,690	28	%
Research and development	62,956	51,703	22	%
General and administrative	35,004	29,167	20	%
Total stock-based compensation	\$234,460	\$189,531	24	%
Percentage of revenues	23	% 26		%

Stock-based compensation increased \$44.9 million during the nine months ended September 30, 2016, compared to the same period in the prior year, primarily due to equity grants to new employees and additional grants to current employees.

**Interest Expense**

	Nine Months Ended September 30,		% Change	
	2016	2015		
(dollars in thousands)				
Interest expense	\$24,746	\$23,124	7	%
Percentage of revenues	2	% 2		%

Interest expense increased \$1.6 million during the nine months ended September 30, 2016 compared to the same period in the prior year, due to the increase in amortization expense of debt discount and issuance costs related to our Notes issued in November 2013.

**Interest Income and Other Income (Expense), net**

	Nine Months Ended September 30,		% Change	
	2016	2015		
(dollars in thousands)				
Interest income	\$5,838	\$3,274	78	%
Foreign currency exchange loss	(1,262 )	(1,771 )	(29 )	%
Other	169	(230 )	NM	
Interest and other income (expense), net	\$4,745	\$1,273	273	%
Percentage of revenues	—	% —		%

Interest income and other income (expense), net, increased \$3.5 million during the nine months ended September 30, 2016 compared to the same period in the prior year, primarily due to lower foreign exchange losses and increased interest income. We had foreign exchange losses of \$1.3 million for the nine months ended September 30, 2016 compared to losses of \$1.8 million for the nine months ended September 30, 2015 as a result of fluctuations in foreign currency exchange rates. Interest income increased \$2.6 million due to higher yields for the nine months ended September 30, 2016.



**Provision for Income Taxes**

	Nine Months Ended September 30,		% Change
	2016	2015	
	(dollars in thousands)		
Loss before income taxes	\$(419,206)	\$(157,358)	166 %
Provision for income taxes	9	3,690	(100 )%
Effective tax rate	—	% (2 )%	

Our effective tax rate changed to 0% for the nine months ended September 30, 2016 compared to (2)% for the nine months ended September 30, 2015 primarily due to our loss from operations, the foreign tax rate differential, a release of the valuation allowance in connection with acquisitions and excess tax benefits related to stock-based compensation.

**Net Loss**

	Nine Months Ended September 30,		% Change
	2016	2015	
	(dollars in thousands)		
Net loss	\$(419,215)	\$(161,048)	160 %
Percentage of revenues	(42 )%	(22 )%	

Net loss increased \$258.2 million during the nine months ended September 30, 2016 compared to the same period in the prior year due primarily to the expenses related to the settlement agreements with HPE and BMC.

**Liquidity and Capital Resources**

	Nine Months Ended September 30,	
	2016	2015
	(dollars in thousands)	
Net cash provided by operating activities	\$27,234	\$211,200
Net cash used in investing activities	(83,238 )	(171,000 )
Net cash (used in) provided by financing activities	(30,765 )	60,632
Net (decrease) increase in cash and cash equivalents, net of foreign currency effect on cash and cash equivalents	(87,238 )	96,618

Our principal sources of liquidity are our cash and cash equivalents, investments, and cash generated from operations. As of September 30, 2016, we had \$806.9 million in cash and cash equivalents and short-term investments, of which \$165.6 million represented cash owned by foreign subsidiaries. In addition, we had \$281.4 million in long-term investments that provide additional capital resources.

We anticipate our current cash and cash equivalents balance and cash generated from operations will be sufficient to meet our liquidity needs including the expansion of data centers, lease obligations, expenditures related to the growth of our headcount, and the acquisition of fixed assets, intangibles and investments in office facilities to accommodate our growth, for at least the next 12 months. Whether these resources are adequate to meet our liquidity needs beyond that period will depend on our growth, operating results, cash utilized for acquisitions, if any are consummated, and the capital expenditures required to meet possible increased demand for our services. If we require additional capital resources to grow our business at any time in the future, we may seek to finance our operations from the current funds available or seek additional equity or debt financing.

***Operating Activities***

Cash provided by operating activities mainly consists of our net loss adjusted for certain non-cash items, including depreciation and amortization, amortization of premiums on investments, amortization of deferred commissions, amortization of issuance cost and debt discount, stock-based compensation and changes in operating assets and liabilities during the year.

Net cash provided by operating activities was \$27.2 million for the nine months ended September 30, 2016 compared to \$211.2 million of net cash provided by operating activities for the nine months ended September 30, 2015. The decrease in operating cash flow was primarily due to \$267.5 million cash paid for aggregate legal settlements during the nine months ended September 30, 2016 (refer to Note 15 in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for further details). The remaining change was due to an increase in non-cash adjustments to reconcile net loss to net cash provided by operations and the favorable impact on operating cash flow from changes in operating assets and liabilities.

### ***Investing Activities***

Net cash used in investing activities for the nine months ended September 30, 2016 was \$83.2 million compared to \$171.0 million for the nine months ended September 30, 2015. The decrease in cash used in investing activities was mainly due to \$147.2 million decrease in net purchases of investments, offset by \$33.2 million increase in business combinations, net of cash acquired, \$14.9 million increase in purchase of other intangibles, and \$21.5 million increase in capital expenditures related to purchases of cloud-based infrastructure hardware equipment to support the expansion of our data centers as well as investments in leasehold improvements, furniture and equipment to support our headcount growth.

### ***Financing Activities***

Net cash used in financing activities for the nine months ended September 30, 2016 was \$30.8 million compared to \$60.6 million of net cash provided by financing activities for the nine months ended September 30, 2015. The change was primarily due to the \$76.0 million increase in taxes paid related to net share settlement of equity awards and the \$18.3 million decrease in proceeds from employee stock plans.

### **Contractual Obligations and Commitments**

Contractual obligations represent future cash commitments and liabilities under agreements with third parties, and exclude orders for goods and services entered into in the normal course of business that are not enforceable or legally binding. Apart from the \$267.5 million cash paid for aggregate legal settlements during the nine months ended September 30, 2016 (refer to Note 15 in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for further details), there have been no material changes in our commitments under contractual obligations, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on February 25, 2016.

### **Off-Balance Sheet Arrangements**

During all periods presented, we did not 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. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in those types of relationships.

### **Critical Accounting Policies and Significant Judgments and Estimates**

Our management's discussion and analysis of financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, as well as the reported revenues and expenses during the reporting periods. These

items are monitored and analyzed by us for changes in facts and circumstances, and material changes in these estimates could occur in the future. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Changes in estimates are reflected in reported results for the period in which they become known. Actual results may differ from these estimates under different assumptions or conditions and such differences could be material.

There have been no significant changes to our critical accounting policies and estimates as described in our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on February 25, 2016.

**ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in our market risk as compared to the disclosures in Part II, Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on February 25, 2016.



## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

Regulations under the Exchange Act require public companies, including our company, to maintain “disclosure controls and procedures,” which are defined in Rule 13a-15(e) and Rule 15d-15(e) to mean a company’s controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required or necessary disclosures. In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Our Chief Executive Officer and Chief Financial Officer have concluded, based on the evaluation of the effectiveness of the disclosure controls and procedures by our management as of the end of the quarter covered by this Quarterly Report on Form 10-Q, that our disclosure controls and procedures were effective at the reasonable assurance level for this purpose.

### **Changes in Internal Control Over Financial Reporting**

Regulations under the Exchange Act require public companies, including our company, to evaluate any change in our “internal control over financial reporting” as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. In connection with their evaluation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer did not identify any change in our internal control over financial reporting during the quarter covered by this Quarterly Report on Form 10-Q that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II**

### **ITEM 1. LEGAL PROCEEDINGS**

On February 6, 2014, Hewlett-Packard Company (Hewlett-Packard) filed a lawsuit against us in the U.S. District Court for the Northern District of California. The lawsuit alleged patent infringement and sought damages and an injunction. On or about November 1, 2015, Hewlett Packard Enterprise Company (HPE) separated from Hewlett-Packard as an independent company, and Hewlett-Packard assigned to HPE all right, title, and interest in the eight Hewlett-Packard patents in the lawsuit and HPE was substituted as plaintiff in the litigation. On March 4, 2016, we entered into a confidential settlement agreement resolving the lawsuit with HPE (HPE Settlement). As a result, on March 9, 2016, the lawsuit was dismissed.

BMC Software, Inc. (BMC) filed lawsuits against us in the U.S. District Court for the Eastern District of Texas on September 23, 2014 and February 12, 2016, and in the Dusseldorf (Germany) Regional Court, Patent Division, on March 2, 2016. Each of the lawsuits alleged patent infringement and sought damages and an injunction. On April 8, 2016, we entered into a confidential settlement agreement resolving all the lawsuits with BMC (BMC Settlement). As a result, the second Texas lawsuit was dismissed on April 14, 2016, and each of the initial Texas lawsuit and the German lawsuit was dismissed on April 25, 2016.

We recorded charges for aggregate legal settlements of \$270.0 million in our condensed consolidated statement of comprehensive loss for the nine months ended September 30, 2016. The charge covers the fulfillment by us of all financial obligations under both the BMC Settlement and HPE Settlement with no remaining financial obligations under either settlement. Refer to Note 15 in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for further details of these matters.

### **ITEM 1A. RISK FACTORS**

*Investing in our securities involves a high degree of risk. You should consider carefully the risks and uncertainties described below, together with all of the other information in this report, including our condensed consolidated financial statements and related notes report, before making an investment decision. We have identified the following risks and uncertainties that may have a material adverse effect on our business, financial condition, results of operations and future prospects. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment.*

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

***We expect our revenue growth rate to continue to decline, and we expect to continue to incur losses in accordance with U.S. Generally Accepted Accounting Principles, or GAAP.***

We have experienced significant revenue growth in prior periods; however, our revenue growth rate is declining and we expect that it will continue to decline into the foreseeable future. We also expect our costs to increase in future periods as we continue to invest in our capacity to support anticipated growth. These investments may not result in increased revenues or growth in our business. Even if our revenues continue to increase, we expect to continue to incur a loss in accordance with GAAP during future periods due to increased costs such as non-cash charges associated with equity awards, business combinations and other expenses. Additionally, we may encounter unforeseen operating expenses, difficulties, complications, delays and other unforeseen or unpredictable factors that may result in increased costs. Furthermore, it is difficult to predict the size and growth rate of our market, customer demand for our products, customer adoption and renewal rates, and the entry of competitive products or the success of existing competitive products. As a result, we may not achieve or maintain profitability in the future, our gross margins may be negatively impacted, and our ability to generate cash flow from operations may be negatively impacted. If we fail to

grow our revenues sufficiently to keep pace with our growing investments and other expenses, our business, operating results and growth prospects will be adversely affected.

***We have recently introduced products in new markets that are important to our growth prospects and for which we do not have a substantial operating history. If we are unsuccessful in competing in these new markets, our revenue growth rate, business and operating results will be adversely affected.***

We have recently introduced products in the markets for IT operations management, customer service, security incident management and the use of our platform for service management outside of enterprise IT. Our successful entry into these and other new markets is important to our revenue growth prospects. We do not have a substantial operating history with these products, which limits our ability to forecast operating results, and the success of our efforts to address these markets depends on many factors, including: the degree of differentiation of our products and services from those offered by more established competitors in these markets; whether our product and services offer compelling benefits and value to customers; the time-frame and quality of our research and development efforts; the rigor and effectiveness of our quality testing and controls; and our ability to successfully market and sell into new markets with which our marketing and sales personnel are less experienced. We may not have the necessary resources, including employees with the required product management, engineering, marketing and sales expertise, to compete effectively in these markets. Any new service that we develop may not be introduced in a timely or cost-effective manner, may not be priced appropriately, may not offer compelling customer benefits compared to competing products and services, and may not achieve the broad market acceptance necessary to generate significant revenues. If we are not able to successfully develop, market and sell these and other newly introduced products and services to our existing customers and prospective new customers our revenue growth rate, business and operating results will be adversely affected.

***If we are unsuccessful in increasing our rate of growth in new geographic markets, our revenue growth rate, business and operating results will be adversely affected.***

Sales outside of North America represented approximately 33% and 32% of our total revenues for each of the three and nine months ended September 30, 2016, respectively. Our business and future prospects depend on increasing our international sales as a percentage of our total revenues, and the failure to grow internationally will harm our business. Additionally, operating in international markets requires significant investment and management attention and will subject us to regulatory and economic risks that are different from those in the United States. We have made, and will continue to make, substantial investments in data centers and cloud computing infrastructure, sales, marketing, personnel and facilities as we enter and expand in new geographic markets, such as Brazil and various countries within Asia. When we make these investments it is typically unclear whether, and when, sales in the new market will justify our investments, and we may significantly underestimate the level of investment and time required to be successful, or whether we will be successful. For example, our rate of acquisition of new Global 2000 customers, a key factor effecting our growth, has generally been greater in North America, Australia and in areas within Europe than it has been in Africa, Asia, Eastern Europe, South America and other markets in which we are less established. Accordingly, if we continue to further penetrate the Global 2000 at a higher rate in our established markets than in our emerging markets, over time an increasing percentage of the overall Global 2000 enterprises that are not yet our customers are in markets in which we have generally had a lower rate of customer acquisition or in which we are not yet competing. Additionally, currency fluctuations in certain countries and regions may negatively impact actual prices that partners and customers are willing to pay in those countries and regions, or the effective prices we realize in our reporting currency. We have experienced, and may continue to experience, difficulties in some of our investments in geographic expansion, including in hiring qualified sales management personnel. If we are unsuccessful in making these investments, or if our required investments are greater than anticipated, our revenue growth rate, business and operating results will be adversely affected.

***We expect competition to cause the sales prices of our products to decline, which may harm our financial results.***

The sales prices for our products, subscriptions and services may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of products and subscriptions, anticipation of the introduction of new products or subscriptions, or promotional programs. Competition continues to increase in the market segments in which we participate, and we expect competition to further increase in the future, thereby leading to increased pricing pressures. Larger competitors with more diverse product and service offerings may reduce the price of products or subscriptions that compete with ours or may bundle them with other products and subscriptions. In addition, we expect that smaller competitors and new entrants may accelerate the decline of prices in the IT service management market, which is our more mature offering and from which we derive the substantial majority of our revenues and will continue to do so for the foreseeable future. Furthermore, we anticipate that the sales prices and gross profits for our products will decrease over product life cycles. We may not be successful in developing and introducing new offerings on a timely basis, and any new product and subscription offerings, if introduced, may not enable us to maintain our prices and gross profits at historical or anticipated levels.

***If we fail to meet the financial performance expectations of investors or securities analysts, the price of our common stock could decline substantially.***

For any quarterly or annual period there is a risk that our financial performance will not meet the financial guidance we have previously given for that period, or that we may otherwise fail to meet the financial performance expectations of the securities analysts who issue reports on our company and our common stock price, or of investors in our common stock. There is also a risk that we may issue forward-looking financial guidance for a quarterly or annual period that fails to meet the expectations of such securities analysts or investors. If any of the foregoing occurs, for any reason either within or outside of our control, the price of our common stock could decline substantially and investors in our common stock could incur substantial losses. Some of the important factors that may cause our revenues, operating results and cash flows, or our forward-looking financial guidance, to fall below the expectations of such securities analysts or investors include:

- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' requirements;
- changes in foreign currency exchange rates;
- the rate of expansion and productivity of our sales force;
- the number of new employees added;
- the cost, timing and management effort for our development of new services;
- general economic conditions that may adversely affect either our customers' ability or willingness to purchase additional subscriptions, delay a prospective customer's purchasing decision, reduce the value of new subscription contracts or affect renewal rates;
- the amount and timing of operating costs and capital expenditures related to the operation and expansion of our business;
- seasonality in terms of when we enter into customer agreements for our services;
- the length of the sales cycle for our services;
- changes in our pricing policies, whether initiated by us or as a result of competition;
- significant security breaches, technical difficulties or interruptions of our services;
- new solutions, products or changes in pricing policies introduced by our competitors;
- changes in effective tax rates;
- changes in the average duration of our customer agreements and changes in billing cycle;
- changes in our renewal and upsell rates;
- the timing of customer payments and payment defaults by customers;
- extraordinary expenses such as litigation costs or damages, including settlement payments;
- the costs associated with acquiring new businesses and technologies and the follow-on costs of integration, including the tax effects of acquisitions;
- the impact of new accounting pronouncements, including the new revenue recognition standards that are effective for us beginning January 1, 2018;
- changes in laws or regulations impacting the delivery of our services;
- the amount and timing of stock awards and the related financial statement expenses; and
- our ability to accurately estimate the total addressable market for our products and services.

***Lawsuits against us by third-parties that allege we infringe their intellectual property rights could harm our business and operating results.***

There is considerable patent and other intellectual property development activity in our industry. Our success depends in part on not infringing upon the intellectual property rights of others. We may be unaware of the intellectual property rights of others that may cover some or all of our technology or services. From time to time, our competitors or other third parties, including patent holding companies seeking to monetize patents they have purchased or

otherwise obtained, may claim that we are infringing upon their intellectual property rights. For example, in 2016 we settled two patent-related litigation matters and recorded a one-time charge of \$270.0 million related to aggregate legal settlements.

In any intellectual property litigation, regardless of the scope or merits of the claims at issue, we may incur substantial attorney's fees and other litigation expenses and, if the claims are successfully asserted against us and we are found to be infringing upon the intellectual property rights of others, we could be required to: pay substantial damages and make substantial ongoing royalty payments; cease offering our products and services; modify our products and services; comply with other unfavorable terms, including settlement terms; and indemnify our customers and business partners and obtain costly licenses on their behalf and refund fees or other payments previously paid to us. Moreover, the mere existence of any lawsuit, or any interim or final outcomes, and the course of its conduct and the public statements related to it (or absence of such statements) by the courts, press, analysts and litigants, could be unsettling to our customers and prospective customers and could cause an adverse impact to our customer satisfaction and related renewal rates and cause us to lose potential sales, and could also be unsettling to investors or prospective investors in our common stock and could cause a substantial decline in the price of our common stock. Accordingly, any claim or litigation against us could be costly, time-consuming and divert the attention of our management and key personnel from our business operations and harm our financial condition and operating results.

***If we suffer a cyber-security event we may lose customers, lose future sales, experience business interruption and injury to our reputation and competitive position, and incur significant liabilities, any of which would harm our business and operating results.***

Our operations involve the storage, transmission and processing of our customers' confidential, proprietary and sensitive information, including in some cases personally identifiable information, protected health information, proprietary information and credit card and other sensitive financial information. While we have security measures in place designed to protect customer information and prevent data loss, they may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise, and result in someone obtaining unauthorized access to our customers' data or our data, including our intellectual property and other confidential business information. A security breach or unauthorized access could result in the loss or exposure of this data, litigation, indemnification and other contractual obligations, government fines and penalties, mitigation expenses and other liabilities. Additionally, the cost and operational consequences of responding to breaches and implementing remediation measures could be significant.

Computer malware, viruses and hacking, phishing and denial of service attacks by third parties have become more prevalent in our industry, and have occurred on our systems in the past and may occur on our systems in the future. Because techniques used to obtain unauthorized access to or sabotage systems change frequently and generally are not recognized until successfully launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. As cyber-security threats develop and grow, it may be necessary to make significant further investments to protect data and infrastructure. If an actual or perceived breach of our security occurs, we could suffer severe reputational damage adversely affecting customer or investor confidence, the market perception of the effectiveness of our security measures could be harmed, we could lose potential sales and existing customers, our ability to deliver our services or operate our business may be impaired, we may be subject to litigation or regulatory investigations or orders, and we may incur significant liabilities. We do not have insurance sufficient to compensate us for the potentially significant losses that may result from security breaches.



***Disruptions in our services could damage our customers' businesses, subject us to substantial liability and harm our reputation and financial results.***

Our customers use our services to manage important aspects of their businesses, and any disruptions in our services could damage our customers' businesses, subject us to substantial liability, and harm our reputation and financial results. From time to time, we experience defects in our services, and new defects may be detected in the future. We provide regular updates to our services, which frequently contain undetected defects when first introduced or released. Defects may also be introduced by our use of third-party software, including open source software. Disruptions may also result from errors we make in delivering, configuring, or hosting our services, or designing, installing, expanding or maintaining our cloud infrastructure. Disruptions in service can also result from incidents that are outside of our control, including denial of service attacks. We currently serve our customers primarily using equipment managed by us and co-located in third-party data center facilities operated by several different providers located around the world. These centers are vulnerable to damage or interruption from earthquakes, floods, fires, power loss and similar events. They may also be subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct, equipment failure and adverse events caused by operator error. Despite precautions taken at these facilities, problems at these facilities could result in lengthy interruptions in our services and the loss of customer data. In addition, our customers may use our services in ways that cause disruptions in service for other customers. Our reputation and business will be adversely affected if our customers and potential customers believe our services are unreliable. Disruptions in our services may reduce our revenues, cause us to issue credits or pay penalties, subject us to claims and litigation, cause our customers to delay payment or terminate or fail to renew their subscriptions, and adversely affect our ability to attract new customers. The occurrence of payment delays, or service credit, warranty, termination for material breach or other claims against us, could result in an increase in our bad debt expense, an increase in collection cycles for accounts receivable, an increase to our warranty provisions or service level credit accruals or other increased expenses or risks of litigation. We do not have insurance sufficient to compensate us for the potentially significant losses that may result from claims arising from disruptions in our services.

***If we are unable to continuously enhance our products and services to deliver consumer product-like experiences, mobility, messaging and ease of use, they could become less competitive or obsolete and our business and operating results will be adversely affected.***

We believe that enterprises are increasingly focused on delivering a consumer-like technology experience to users within the enterprise, such as employees, and to individuals interacting with the enterprise, such as customers, partners and suppliers. Accordingly, our ability to attract new customers and to renew and increase revenues from existing customers depends on our ability to continuously enhance our products and services and provide them in ways that are broadly accepted. In particular, we need to continuously modify and improve our products and services to keep pace with changes in user expectations, including intuitive and attractive user interfaces, use and mobility features, messaging, social networking, and communication, database, hardware and security technologies. If we are unable to consistently and timely meet these requirements, our products and services may become less marketable and less competitive or obsolete, and our business and operating results will be adversely affected.

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

The markets in which we compete to manage services across the enterprise are fragmented, rapidly evolving and highly competitive, with relatively low barriers to entry. As the market for service management matures, we expect competition to intensify. We face competition from in-house solutions, large integrated systems vendors, and established and emerging cloud and software vendors. Our competitors vary in size and in the breadth and scope of the products and services offered. Many of our competitors and potential competitors are larger, have greater name recognition, longer operating histories, more established customer relationships, larger marketing budgets and greater resources than we do. Furthermore, third parties with greater available resources and the ability to initiate or withstand substantial price competition may acquire our current or potential competitors. Our primary competitors include BMC Software, Inc., CA, Inc., Hewlett Packard Enterprise Company, International Business Machines Corporation and Salesforce.com. Further, other potential competitors not currently offering competitive products may expand their services to compete with our services. As we expand the breadth of our services to include offerings in the markets for IT operations management, customer service, security incident management and use of our platform for service management outside of enterprise IT, we expect increasing competition from platform vendors and from application development vendors focused on these other markets. Our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards and customer requirements. An existing competitor or new entrant could introduce new technology that reduces demand for our services. In addition to product and technology competition, we face pricing competition. Some of our competitors offer their products or services at a lower price, which has resulted in pricing pressures. Some of our larger competitors have the operating flexibility to bundle competing products and services with other software offerings, including offering them at a lower price as part of a larger sale. For all of these reasons, we may not be able to compete successfully and competition could result in reduced sales, reduced margins, losses or the failure of our services to achieve or maintain market acceptance, any of which could harm our business.

***If we lose key employees or are unable to attract and retain the employees we need, our business and operating results will be adversely affected.***

Our success depends largely upon the continued services of our management team and many key individual contributors. From time to time, there may be changes in our management team resulting from the hiring or departure of employees, which could disrupt our business. For example, our founder and Chief Product Officer, Frederic Luddy, retired in October 2016, although he continues to serve as a member of our board of directors. Our employees are generally employed on an at-will basis, which means that our employees could terminate their employment with us at any time. The loss of one or more members of our management team or other key employees could have a serious impact on our business. In the technology industry, there is substantial and continuous competition for engineers with high levels of experience in designing, developing and managing software and Internet-related solutions, as well as competition for sales executives and operations personnel. We may not be successful in attracting and retaining qualified personnel. We have from time to time experienced, and we may continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. In particular, competition for experienced software and cloud computing infrastructure engineers in the San Francisco Bay area, San Diego, Seattle, London and Amsterdam, our primary operating locations, is intense. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be adversely affected.

***Our revenue growth rate, business and operating results will be adversely affected if we fail to effectively expand our sales and marketing capabilities.***

Increasing our customer base and achieving broader market acceptance of our services will depend, to a significant extent, on our ability to effectively expand our sales and marketing operations and activities. We are substantially

dependent on our direct sales force to obtain new customers. From September 30, 2015 to September 30, 2016, our sales and marketing organization increased from 1,254 to 1,740 employees. We plan to continue to expand our direct sales force both domestically and internationally. There is significant competition for direct sales personnel with the sales skills and technical knowledge that we require. Our ability to achieve significant revenue growth in the future will depend, in large part, on our success in recruiting, training and retaining a sufficient number of direct sales personnel and we may be unable to hire or retain sufficient numbers of qualified individuals. Newly hired employees require significant training and time before they achieve full productivity, particularly in new sales territories, and our recent hires and planned hires may not become as productive as quickly as we plan, or at all. Further, in our less established markets such as Africa, Asia, Eastern Europe and South America, we do not have significant experience as an organization developing and implementing sales and marketing campaigns, and such campaigns may be expensive and difficult to implement, and we may be unable to attract and retain qualified personnel to conduct such campaigns. It may take a considerable period of time for operations in new geographies to generate a positive impact to operating margin and we may be unsuccessful in generating meaningful revenues or any operating margin over the long term. Our business will be adversely affected if our sales and marketing expansion efforts do not generate a significant increase in revenues.

***Our business depends substantially on our existing customers renewing their subscriptions upon expiration of their subscription term and purchasing additional subscriptions from us. Any decline in renewals or additional purchases would harm our business and operating results.***

In order for us to maintain or improve our operating results, it is important that our existing customers renew their subscriptions upon expiration of the subscription contract term and expand their use of our services by adding new users and applying our products and services in new ways across their enterprise. Our customers have no obligation to renew their subscriptions, and our customers may not renew subscriptions with a similar contract period or with the same or a greater number of users. Although our renewal rates have historically been high, some of our customers have elected not to renew their agreements with us and we cannot accurately predict renewal rates. Moreover, in some cases, some of our customers have the right to cancel their agreements prior to the expiration of the term. Our renewal rates may decline or fluctuate as a result of a number of factors, including: our customers' satisfaction with our products and services and customer support; our prices and pricing policies and the prices of competing products and services; mergers and acquisitions affecting our customer base; customer personnel changes; global economic conditions; or reductions in our customers' spending levels. Our renewal rates may also decline based on our customers' satisfaction with the implementation and other professional services of our partners, or the quality of implementations by our customers, all of which are generally outside of our control. If our customers do not renew their subscriptions, renew on less favorable terms, fail to add more authorized users, fail to purchase additional professional services, decline to act as enthusiastic reference accounts for our customer prospects, or disparage our products and services, our revenue growth rate, business and operating results will be adversely affected.

***Our revenue growth depends in part on the success of our strategic relationships with third parties and their continued performance.***

We depend on our channel partners, including our implementation partners, systems integrators, managed services providers and sales partners in order to grow our business. Our sales efforts have focused on large enterprise customers and there are a limited number of partners with the capacity to provide these customers an effective level of services. In order to continue our revenue growth, we need to recruit these partners and these partners need to devote substantial resources to our solutions. Accordingly, we need to build services, implement partner programs, and provide training and other resources to recruit, retain and enable these partners. Our agreements with partners are typically non-exclusive and do not prohibit them from working with our competitors or from offering competing solutions. Our competitors may be effective in providing incentives to our partners to favor their solutions or otherwise disrupt the relationships we have with our partners. In addition, global economic conditions could harm the businesses of our partners, and it is possible that they may not be able to devote the additional resources to the relationship that we expect. If we are unsuccessful in establishing or maintaining our relationships with our channel partners, our ability to compete in the marketplace or to grow our revenues could be impaired and our operating results would suffer. To compete in the markets for our newly introduced products in the markets for IT operations management, customer service, security incident management and use of our platform for service management outside of enterprise IT, we may need to establish relationships with additional sales and implementation partners. Further, reliance on third parties exposes us to risk of poor performance and failed customer expectations. If our channel partners do not effectively provide services or support to the satisfaction of our end-customers, we may incur additional costs to address the situation, the profitability of that work might be impaired, and the customer's dissatisfaction could damage our reputation or ability to obtain additional revenues from that customer or prospective customers.

***Privacy laws and concerns, evolving regulation of cloud computing, and the changes in laws, regulations and standards related to personal data and the Internet may cause our business to suffer.***

Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws and regulations affecting data privacy, the use of the Internet as a commercial medium, and data sovereignty requirements concerning the location of data centers that store and process data. Industry organizations also regularly adopt and advocate for new standards in these areas. Changing laws, regulations and standards applying to the solicitation, collection, transfer, processing, storage or use of personal or consumer information could affect our customers' ability to use and share data, potentially restricting our ability to store, process and share data with our customers in connection with providing our services, and in some cases could impact our ability to offer our services in certain locations or our customers' ability to deploy our services globally. For example, the European Court of Justice in October 2015 issued a ruling immediately invalidating the U.S.-EU Safe Harbor framework that had been in place since 2000, which facilitated the transfer of personal data from the European Economic Area to the United States in compliance with applicable European data protection laws. While other adequate legal mechanisms for lawfully transferring European personal data to the United States remain, there is regulatory uncertainty surrounding how data transfers from the European Economic Area to the United States will be authorized in the future. In addition, the June 23, 2016 referendum by British voters to exit the European Union may further exacerbate many of the risks and uncertainties described above. Future laws, regulations, standards and other obligations, and changes in the interpretation of existing laws, regulations, standards and other obligations could impair our or our customers' ability to collect, use or disclose information relating to individuals, which could decrease demand for our applications, adversely impact our business operations, including potentially relocating our data centers, increase our costs and impair our ability to maintain and grow our customer base and increase our revenue. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet, commerce conducted via the Internet or validation that particular processes follow the latest standards. These changes could limit the viability of cloud computing services such as ours. If we are not able to adjust to changing laws, regulations and standards related to the Internet, our business may be adversely affected.

***Prospective customers that have not yet embraced cloud computing solutions may continue to be reluctant, slow, or unwilling to do so, any of which could harm our business and operating results.***

We do not know whether the trend of adoption of enterprise cloud computing solutions from which we have benefited in the past will continue in the future at the same overall growth rates. Many organizations have invested substantial personnel and financial resources to integrate enterprise software into their businesses over time, and some have been reluctant or unwilling to migrate to cloud computing solutions. Furthermore, some organizations have been reluctant or unwilling to use cloud computing solutions because they have concerns regarding the risks associated with the security of their data, the physical location of data centers in which their data is stored and processed, and the reliability of the technology delivery model associated with these solutions. In addition, if either we or other cloud computing providers experience security incidents, loss of customer data, disruptions in our service, or other problems, the market for cloud computing solutions as a whole, including for our products and services, will be negatively impacted. For these and other reasons, there is a substantial risk that enterprises (including Global 2000 enterprises on which we are dependent for sales growth) that have not yet embraced cloud computing solutions will continue to be reluctant, slow, or be unwilling to do so, or willing to do so only to a limited extent, any of which could harm our business.

***Foreign currency exchange rate fluctuations could harm our financial results.***

We conduct significant transactions, including revenue transactions and intercompany transactions, in currencies other than the U.S. Dollar or the functional operating currency of the transactional entities. In addition, our international subsidiaries maintain significant net assets that are denominated in currencies other than the functional operating

currencies of these entities. Accordingly, changes in the value of currencies relative to the U.S. Dollar may impact our consolidated revenues and operating results due to transactional and translational remeasurement that is reflected in our earnings. It is particularly difficult to forecast any impact from exchange rate movements, so there is risk that unanticipated currency fluctuations could adversely affect our results or cause our results to differ from investor expectations or our own guidance in any future periods. In addition, the June 23, 2016 referendum by British voters to exit the European Union adversely impacted global markets, including currencies, and resulted in a decline in the value of the British pound, as compared to the U.S. Dollar and other currencies. Volatility in exchange rates may continue as the United Kingdom negotiates its exit from the European Union.

We do not currently maintain a program to hedge transactional exposures in foreign currencies. However, in the future, we may use derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place. Moreover, the use of hedging instruments may introduce additional risks if we are unable to structure effective hedges with such instruments.

***Because we recognize revenues from our subscription service over the subscription term, downturns or upturns in new sales and renewals will not be immediately reflected in our operating results.***

We generally recognize revenues from customers ratably over the terms of their subscriptions. As a result, most of the revenues we report in each quarter are derived from the recognition of deferred revenues relating to subscriptions entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any single quarter will likely have only a small, and perhaps no apparent, impact on our revenue results for that quarter. Such a decline, however, will negatively affect our revenues in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our services, and potential changes in our rate of renewals, 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 revenues through additional sales in any period, as revenues from new customers must be recognized over the applicable subscription term. In addition, we may be unable to adjust our cost structure to reflect the changes in revenues.

***Unanticipated changes in our effective tax rate could harm our financial results.***

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of earnings and losses in differing jurisdictions. We believe that our provision for income taxes is reasonable, but the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made. Our effective tax rate could be adversely affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses as a result of acquisitions, the valuation of deferred tax assets and liabilities and changes in federal, state or international tax laws and accounting principles. Increases in our effective tax rate would reduce our profitability or in some cases increase our losses.

Our tax provision could be impacted by changes in federal, state, or international tax laws or tax rulings. For example, the current U.S. administration and key members of Congress have made public statements indicating that tax reform is a priority. Certain changes to U.S. tax laws, including limitations on the ability to defer U.S. taxation on earnings outside of the United States until those earnings are repatriated to the United States, could affect the tax treatment of our foreign earnings. Many countries are actively considering changes to existing tax laws or have proposed or enacted new laws, such as legislation recently proposed or enacted in the United Kingdom and in Australia. In October 2015, the Organization for Economic Co-Operation and Development released final guidance covering various topics, including transfer pricing, country-by-country reporting and definitional changes to permanent establishment which could ultimately impact our tax liabilities. Any changes in federal, state, or international tax laws or tax rulings may increase our worldwide effective tax rate and harm our financial position and results of operations.

In addition, we may be subject to income tax audits by tax jurisdictions throughout the world, many of which have not established clear guidance on the tax treatment of cloud computing companies. Although we believe our income tax liabilities are reasonably estimated and accounted for in accordance with applicable laws and principles, an adverse resolution of one or more uncertain tax positions in any period could have a material impact on the results of operations for that period.

***We may acquire or invest in companies and technologies, which may divert our management's attention, and result in additional dilution to our stockholders. We may be unable to integrate acquired businesses and technologies successfully or achieve the expected benefits of such acquisitions or investments.***

As part of our business strategy, we have acquired companies in the past and may evaluate and consider potential strategic transactions, including acquisitions of, or investments in, businesses, technologies, services, products and other assets in the future. We also may enter into relationships with other businesses to expand our service offerings or

our ability to provide services in international locations, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing or investments in other companies. An acquisition, investment or business relationship 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 the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, their technology is not easily adapted to work with ours, or we have difficulty retaining the customers of any acquired business due to changes in ownership, management or otherwise.



Negotiating these transactions can be time-consuming, difficult and expensive, and our ability to close these transactions may often be subject to conditions or approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close. For one or more of those 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 retaining key employees of the acquired company or integrating diverse technologies, software or business cultures; and
- become subject to adverse tax consequences, substantial depreciation or deferred compensation charges.

Acquisitions or other strategic investments may also disrupt our business, divert our resources and require significant management attention that would otherwise be available for development of our existing business. Moreover, the anticipated benefits of any acquisition, investment or business relationship may not be realized or we may be exposed to unknown risks or liabilities.

***A portion of our revenues are generated by sales to government entities and heavily regulated organizations, which are subject to a number of challenges and risks.***

A portion of our sales are to governmental agencies. Additionally, many of our current and prospective customers, such as those in the financial services and health care industries, are highly regulated and may be required to comply with more stringent regulations in connection with subscribing to and implementing our services. Selling to these entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that we will successfully complete a sale. Furthermore, engaging in sales activities to foreign governments introduces additional compliance risks specific to the Foreign Corrupt Practices Act, the UK Bribery Act and other similar statutory requirements prohibiting bribery and corruption in the jurisdictions in which we operate. Government and highly regulated entities often require contract terms that differ from our standard arrangements and impose compliance requirements that are complicated, require preferential pricing or “most favored nation” terms and conditions, or are otherwise time consuming and expensive to satisfy. If we undertake to meet special standards or requirements and do not meet them, we could be subject to increased liability from our customers or regulators. Even if we do meet them, the additional costs associated with providing our services to government and highly regulated customers could harm our margins. Moreover, changes in the underlying regulatory conditions that affect these types of customers could harm our ability to efficiently provide our services to them and to grow or maintain our customer base.

***Our sales cycles are long, and if they lengthen further, or if our substantial upfront sales investments do not result in sufficient sales, our business and operating results could be adversely affected.***

We target our sales efforts at large enterprise customers. Because these customers are often making an enterprise-wide decision to deploy our services, sometimes on a global basis, we face long and variable sales cycles, complex customer requirements, substantial upfront pre-sales costs and less predictability in completing some of our sales. Our sales cycle is generally six to nine months, but is variable and difficult to predict and can be much longer. Furthermore, large enterprises often undertake a prolonged evaluation of our services, including whether they need professional services performed by us or a third party for their service management needs, and a comparison of our services to products offered by our competitors. Some of our large enterprise customers initially deploy our services on a limited basis, with no guarantee that these customers will deploy our services widely enough across their organization to justify our substantial pre-sales investment. If our sales cycle lengthens or our substantial upfront pre-sales investments do not result in sufficient subscription revenues to justify our investments, our operating results

could be adversely affected.

***Sales to customers outside North America expose us to risks inherent in international sales.***

Because we sell our services throughout the world, we are subject to risks that we would otherwise not face if we conducted our business only in North America. The business conduct and ethical standards of many other countries, including the emerging market countries that we are expanding into, are substantially different and much less rigorous than the United States. Risks inherent with international sales include without limitation:

- foreign currency fluctuations which may cause exchange and translation losses;
- compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, competition, privacy and data protection laws and regulations;
- compliance by us and our business partners with international bribery and corruption laws, including the UK Bribery Act and the Foreign Corrupt Practices Act;
- the risk that illegal or unethical activities of our business partners will be attributed to or result in liability to us;
- compliance with regional data privacy laws that apply to the transmission of our customers' data across international borders, many of which are stricter than the equivalent U.S. laws;
- difficulties in staffing and managing foreign operations;
- different or lesser protection of our intellectual property;
- longer and potentially more complex sales cycles;
- longer accounts receivable payment cycles and other collection difficulties;
- treatment of revenues from international sources and changes to tax codes, including being subject to foreign tax laws and being liable for paying withholding, income or other taxes in foreign jurisdictions;
- different pricing and distribution environments;
- local business practices and cultural norms that may favor local competitors;
- localization of our services, including translation into foreign languages and associated expenses; and
- regional economic and political conditions.

Any of these factors could negatively impact our business and results of operations.

***Our intellectual property protections may not provide us with a competitive advantage, and defending our intellectual property may result in substantial expenses that harm our operating results.***

Our success depends to a significant degree on our ability to protect our proprietary technology and our brand under a combination of patent and other intellectual property laws of the United States and other jurisdictions. Though we seek patent protection for our technology, we may not be successful in obtaining patent protection, and any patents issued in the future may not provide us with competitive advantages, or may be successfully challenged by third parties. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain. Any of our intellectual property rights may be challenged by others or invalidated through administrative process or litigation. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our services are available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States, and mechanisms for enforcement of intellectual property rights may be inadequate. We may be required to spend significant resources to monitor and protect our intellectual property rights. We have, and in the future may, initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us, divert the efforts of our technical and management personnel and may result in counter-claims with respect to infringement of intellectual property rights by us. If we are unable to prevent third parties from infringing upon or misappropriating our intellectual property, or are required to incur substantial expenses in defending our intellectual property rights, our business and operating results may be adversely affected.



***Our use of open source software could harm our ability to sell our services and subject us to possible litigation.***

Our products incorporate software licensed to us by third-party authors under open source licenses, and we may continue to incorporate open source software into other services in the future. We attempt to monitor our use of open source software in an effort to avoid subjecting our services to adverse licensing conditions. However, there can be no assurance that our efforts have been or will be successful. There is little or no legal precedent governing the interpretation of the terms of open source licenses, and therefore the potential impact of these terms on our business is uncertain and enforcement of these terms may result in unanticipated obligations regarding our services and technologies. For example, depending on which open source license governs open source software included within our services or technologies, we may be subjected to conditions requiring us to offer our services to users at no cost; make available the source code for modifications and derivative works based upon, incorporating or using the open source software; and license such modifications or derivative works under the terms of the particular open source license. Moreover, if an author or other third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal costs defending ourselves against such allegations, be subject to significant damages or be enjoined from the distribution of our services.

***If we are unable to maintain effective internal control over financial reporting, the accuracy and timeliness of our financial reporting may be adversely affected.***

The Sarbanes-Oxley Act requires us, among other things, to assess and report on the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. In addition, our independent registered public accounting firm is required to audit the effectiveness of our internal control over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act annually. Our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. Moreover, our testing, or the subsequent testing by our independent registered public accounting firm, may reveal material weaknesses. If material weaknesses are identified or we are not able to comply with the requirements of Section 404 in a timely manner, our reported financial results could be materially misstated or could subsequently require restatement, we could receive an adverse opinion regarding our internal control over financial reporting from our independent registered public accounting firm, we could be subject to investigations or sanctions by regulatory authorities and we could incur substantial expenses.

***Natural disasters and other events beyond our control could harm our business.***

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 negative effect on us. Our business operations are subject to interruption by natural disasters, flooding, fire, power shortages, pandemics, terrorism, political unrest and other events beyond our control. Although we maintain crisis management and disaster response plans, such events could make it difficult or impossible for us to deliver our services to our customers, could decrease demand for our services, and would cause us to incur substantial expense. Our insurance may not be sufficient to cover losses or additional expense that we may sustain in connection with any natural disaster. The majority of our research and development activities, corporate offices, information technology systems, and other critical business operations are located near major seismic faults in California. Customer data could be lost, significant recovery time could be required to resume operations and our financial condition and operating results could be adversely affected in the event of a major natural disaster or catastrophic event.

***Weakened global economic conditions may harm our industry, business and results of operations.***

Our overall performance depends in part on worldwide economic conditions. Global financial developments seemingly unrelated to us or the software industry may harm us. The United States and other key international economies have been impacted by high levels of bad debt globally, geopolitical instability, slowing economic growth in China, falling demand for a variety of goods and services including oil and other commodities, high levels of persistent unemployment and wage and income stagnation in some geographic markets, restricted credit, poor liquidity, reduced corporate profitability, volatility in credit, equity and foreign exchange markets, bankruptcies and overall uncertainty with respect to the economy. In addition, the June 23, 2016 referendum by British voters to exit the European Union creates significant future economic uncertainties across the European Economic Area, including the United Kingdom. These conditions affect the rate of information technology spending and could adversely affect our customers' ability or willingness to purchase our services, delay prospective customers' purchasing decisions, reduce the value or duration of their subscriptions, or affect renewal rates, all of which could harm our operating results. In addition, the effects, if any, of global financial conditions on our business can be difficult to distinguish from the effects on our business from product, pricing, and other developments in the markets specific to our products and our relative competitive strength. If we make incorrect judgments about our business for this reason our business and results of operations could be adversely affected.

## **Risks Related to Our 0% Convertible Senior Notes Due 2018, or the Notes**

*Although the Notes are referred to as convertible senior notes, they are effectively subordinated to any of our secured debt and any liabilities of our subsidiaries.*

The Notes will rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to any of our liabilities that are not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of our subsidiaries. In the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior in right of payment to the Notes will be available to pay obligations on the Notes only after the secured debt has been repaid in full from these assets, and the assets of our subsidiaries will be available to pay obligations on the Notes only after all claims senior to the Notes have been repaid in full. There may not be sufficient assets remaining to pay amounts due on any or all of the Notes then outstanding. The indenture governing the Notes does not prohibit us from incurring additional senior debt or secured debt, nor does it prohibit any of our current or future subsidiaries from incurring additional liabilities.

As of September 30, 2016, we and our subsidiaries had \$499.3 million in consolidated indebtedness, and our subsidiaries had \$326.3 million of liabilities (including trade payables but excluding intercompany obligations and liabilities of a type not required to be reflected on a balance sheet of such subsidiaries in accordance with GAAP) to which the Notes would have been structurally subordinated.

*Recent and future regulatory actions and other events may adversely affect the trading price and liquidity of the Notes.*

We expect that many investors in, and potential purchasers of, the Notes will employ, or seek to employ, a convertible arbitrage strategy with respect to the Notes. Investors would typically implement such a strategy by selling short the common stock underlying the Notes and dynamically adjusting their short position while continuing to hold the Notes. Investors may also implement this type of strategy by entering into swaps on our common stock in lieu of or in addition to short selling the common stock.

The SEC and other regulatory and self-regulatory authorities have implemented various rules and taken certain actions, and may in the future adopt additional rules and take other actions, that may impact those engaging in short selling activity involving equity securities (including our common stock). Such rules and actions include Rule 201 of SEC Regulation SHO, the adoption by the Financial Industry Regulatory Authority, Inc. and the national securities exchanges of a “Limit Up-Limit Down” program, the imposition of market-wide circuit breakers that halt trading of securities for certain periods following specific market declines, and the implementation of certain regulatory reforms required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Any governmental or regulatory action that restricts the ability of investors in, or potential purchasers of, the Notes to effect short sales of our common stock, borrow our common stock or enter into swaps on our common stock could adversely affect the trading price and the liquidity of the Notes.

*We may still incur substantially more debt or take other actions which would diminish our ability to make payments on the Notes when due.*

We and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our future debt instruments, some of which may be secured debt. We are not restricted under the terms of the indenture governing the Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the Notes that

could have the effect of diminishing our ability to make payments on the Notes when due.

***We may not have the ability to raise the funds necessary to settle conversions of the Notes in cash or to repurchase the Notes upon a fundamental change, and our future debt may contain limitations on our ability to pay cash upon conversion or repurchase of the Notes.***

Holders of the Notes will have the right to require us to repurchase all or a portion of their Notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid special interest, if any. In addition, upon conversion of the Notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefor or pay cash with respect to Notes being converted.



In addition, our ability to repurchase or to pay cash upon conversion of the Notes may be limited by law, regulatory authority or agreements governing our future indebtedness. Our failure to repurchase Notes at a time when the repurchase is required by the indenture or to pay cash upon conversion of the Notes as required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness. Moreover, the occurrence of a fundamental change under the indenture could constitute an event of default under any such agreements. If the payment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or to pay cash upon conversion of the Notes.

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

In the event the conditional conversion feature of the Notes is triggered, holders of Notes will be entitled to convert the Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation in cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

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

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

***Holders of Notes will not be entitled to any rights with respect to our common stock, but they will be subject to all changes made with respect to them to the extent our conversion obligation includes shares of our common stock.***

Holders of Notes will not be entitled to any rights with respect to our common stock (including, without limitation, voting rights and rights to receive any dividends or other distributions on our common stock) prior to the conversion date relating to such Notes (if we have elected to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), but holders of Notes will be subject to all changes affecting our common stock. For example, if an amendment is proposed to our restated certificate of incorporation or restated

bylaws requiring stockholder approval and the record date for determining the stockholders of record entitled to vote on the amendment occurs prior to the conversion date related to a holder's conversion of its Notes (if we have elected to settle the relevant conversion by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share)) or the last trading day of the relevant observation period (if we elect to pay and deliver, as the case may be, a combination of cash and shares of our common stock in respect of the relevant conversion), such holder will not be entitled to vote on the amendment, although such holder will nevertheless be subject to any changes affecting our common stock.

***The conditional conversion feature of the Notes could result in note holders receiving less than the value of our common stock into which the Notes would otherwise be convertible.***

Prior to the close of business on the business day immediately preceding July 1, 2018, holders of our Notes may convert their Notes only if specified conditions are met. If the specific conditions for conversion are not met, holders will not be able to convert their Notes, and they may not be able to receive the value of the cash, common stock or a combination of cash and common stock, as applicable, into which their Notes would otherwise be convertible.

***Upon conversion of the Notes, note holders may receive less valuable consideration than expected because the value of our common stock may decline after holders exercise their conversion right but before we settle our conversion obligation.***

Under the Notes, a converting holder will be exposed to fluctuations in the value of our common stock during the period from the date such holder surrenders Notes for conversion until the date we settle our conversion obligation.

Upon conversion of the Notes, we have the option to pay or deliver, as the case may be, cash, shares of our common stock, or a combination of cash and shares of our common stock. If we elect to satisfy our conversion obligation in cash or a combination of cash and shares of our common stock, the amount of consideration that a note holder will receive upon conversion of such holder's Notes will be determined by reference to the volume weighted average prices of our common stock for each trading day in a 30 trading-day observation period. This period would be: (i) if the relevant conversion date occurs prior to July 1, 2018, the 30 consecutive trading days beginning on, and including, the second trading day immediately succeeding such conversion date; and (ii) if the relevant conversion date occurs during the period from, and including, July 1, 2018 to the close of business on the second scheduled trading day immediately preceding November 1, 2018, the 30 consecutive trading days beginning on, and including, the 32nd scheduled trading day immediately preceding the maturity date. Accordingly, if the price of our common stock decreases during this period, the amount and/or value of consideration note holders receive will be adversely affected. In addition, if the market price of our common stock at the end of such period is below the average of the daily volume weighted average prices of our common stock during such period, the value of any shares of our common stock that note holders will receive in satisfaction of our conversion obligation will be less than the value used to determine the number of shares that holders will receive.

If we elect to satisfy our conversion obligation solely in shares of our common stock upon conversion of the Notes, we will be required to deliver the shares of our common stock, together with cash for any fractional share, on the third business day following the relevant conversion date (or, for conversions occurring on or after July 1, 2018, on the maturity date). Accordingly, if the price of our common stock decreases during this period, the value of the shares that holders receive will be adversely affected and would be less than the conversion value of the Notes on the conversion date.

***The Notes are not protected by restrictive covenants.***

The indenture governing the Notes does not contain any financial or operating covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. The indenture contains no covenants or other provisions to afford protection to holders of the Notes in the event of a fundamental change or other corporate transaction involving us except in certain cases described in the indenture connected with fundamental changes, consolidations, mergers or sales of assets.

***The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change may not adequately compensate holders of the Notes for any lost value of the Notes as a result of such transaction.***

If a make-whole fundamental change occurs prior to maturity, under certain circumstances, we will increase the conversion rate by a number of additional shares of our common stock for Notes converted in connection with such make-whole fundamental change. The increase in the conversion rate will be determined based on the date on which the specified corporate transaction becomes effective and the price paid (or deemed to be paid) per share of our common stock in such transaction. The increase in the conversion rate for Notes converted in connection with a make-whole fundamental change may not adequately compensate holders for any lost value of the Notes as a result of such transaction. In addition, if the price of our common stock in the transaction is greater than \$250.00 per share or less than \$53.73 per share (in each case, subject to adjustment), no additional shares will be added to the conversion rate. Moreover, in no event will the conversion rate per \$1,000 principal amount of Notes as a result of this adjustment exceed 18.6115 shares of common stock, subject to adjustment in the same manner as the conversion rate.

Our obligation to increase the conversion rate for Notes converted in connection with a make-whole fundamental change could be considered a penalty, in which case the enforceability thereof would be subject to general principles of reasonableness and equitable remedies.

***The conversion rate of the Notes may not be adjusted for all dilutive events.***

The conversion rate of the Notes is subject to adjustment for certain events, including, but not limited to, the issuance of certain stock dividends on our common stock, the issuance of certain rights or warrants, subdivisions, combinations, distributions of capital stock, indebtedness, or assets, cash dividends and certain issuer tender or exchange offers. However, the conversion rate will not be adjusted for other events, such as a third-party tender or exchange offer or an issuance of common stock for cash, that may adversely affect the trading price of the Notes or our common stock. An event that adversely affects the value of the Notes may occur, and that event may not result in an adjustment to the conversion rate.

***Provisions in the indenture for the Notes may deter or prevent a business combination that may be favorable to note holders.***

If a fundamental change occurs prior to the maturity date of the Notes, holders of the Notes will have the right, at their option, to require us to repurchase all or a portion of their Notes. In addition, if a make-whole fundamental change occurs prior to the maturity date of the Notes, we will in some cases be required to increase the conversion rate for a holder that elects to convert its Notes in connection with such make-whole fundamental change. 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 and the indenture. These and other provisions in the indenture could deter or prevent a third party from acquiring us even when the acquisition may be favorable to note holders.

***Some significant restructuring transactions may not constitute a fundamental change, in which case we would not be obligated to offer to repurchase the Notes.***

Upon the occurrence of a fundamental change, note holders have the right to require us to repurchase all or a portion of the Notes. However, the fundamental change provisions will not afford protection to holders of Notes in the event of other transactions that could adversely affect the Notes. For example, transactions such as leveraged recapitalizations, refinancings, restructurings, or acquisitions initiated by us may not constitute a fundamental change requiring us to offer to repurchase the Notes. In the event of any such transaction, the holders would not have the right to require us to repurchase the Notes, even though each of these transactions could increase the amount of our indebtedness, or otherwise adversely affect our capital structure or any credit ratings, thereby adversely affecting the holders of Notes.

In addition, absent the occurrence of a fundamental change or a make-whole fundamental change, changes in the composition of our board of directors will not provide holders with the right to require us to repurchase the Notes or to an increase in the conversion rate upon conversion.

***We have not registered the Notes or the common stock issuable upon conversion of the Notes, if any, which will limit the ability of note holders to resell them.***

The Notes and the shares of common stock issuable upon conversion of the Notes, if any, have not been registered under the Securities Act of 1933, as amended, or the Securities Act, or any state securities laws. Unless the Notes and any shares of common stock issuable upon conversion of the Notes have been registered, they may not be transferred or resold except in a transaction exempt from or not subject to the registration requirements of the Securities Act and applicable state securities laws. We do not intend to file a registration statement for the resale of the Notes and the common stock, if any, into which the Notes are convertible.

***We cannot guarantee an active trading market for the Notes.***

We have not listed and do not intend to apply to list the Notes on any securities exchange or to arrange for quotation on any automated dealer quotation system. Moreover, the initial purchasers of the Notes may cease making a market in the Notes at any time without notice. In addition, the liquidity of the trading market in the Notes, and the market price quoted for the Notes, may be adversely affected by changes in the overall market for this type of security and by changes in our financial performance or prospects or in the prospects for companies in our industry generally. As a result, we cannot assure note holders that there will be an active trading market for the Notes. If an active trading market is not maintained, the market price and liquidity of the Notes may be adversely affected. In that case, note holders might not be able to sell the Notes at a particular time or at a favorable price.

***Any adverse rating of the Notes may cause their trading price to fall.***

We have not obtained and do not intend to seek a rating on the Notes. However, if a rating service were to rate the Notes and if such rating service were to lower its rating on the Notes below the rating initially assigned to the Notes or otherwise announces its intention to put the Notes on credit watch, the trading price of the Notes could decline.

***Note holders may be subject to tax if we make or fail to make certain adjustments to the conversion rate of the Notes even though note holders do not receive a corresponding cash distribution.***

The conversion rate of the Notes is subject to adjustment in certain circumstances, including the payment of cash dividends. If the conversion rate is adjusted as a result of a distribution that is taxable to our common stockholders, such as a cash dividend, note holders may be deemed to have received a dividend subject to U.S. federal income tax without the receipt of any cash. In addition, a failure to adjust (or to adjust adequately) the conversion rate after an event that increases a note holder's proportionate interest in us could be treated as a deemed taxable dividend to such note holder. If a make-whole fundamental change occurs prior to maturity, under some circumstances, we will increase the conversion rate for Notes converted in connection with the make-whole fundamental change. Such increase may also be treated as a distribution subject to U.S. federal income tax as a dividend. If a holder is a non-U.S. holder, any deemed dividend generally would be subject to U.S. federal withholding tax at a 30% rate, or such lower rate as may be specified by an applicable treaty, which may be set off against subsequent payments on the Notes.

***Any factors impacting the price of our common stock, including without limitation 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.***

The price of our common stock may be volatile, and the price of our common stock could decline because of many factors, including, without limitation, if we 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, settlement of restricted stock units and issuance of performance shares pursuant to our employee benefit plans, for purchase by employees under our employee stock purchase plan, upon conversion of the Notes and in relation to the warrant transactions we entered into in connection with the pricing 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.

***The convertible note hedge and warrant transactions may affect the value of the Notes and our common stock.***

In connection with the sale of the Notes, we entered into convertible note hedge, or Note Hedge, transactions with certain financial institutions (option counterparties). We also entered into warrant transactions with the option counterparties pursuant to which we sold warrants for the purchase of our common stock, or Warrants. The Note Hedge transactions are expected generally to reduce the potential dilution upon any conversion of Notes and/or offset any cash payments we are required to make in excess of the principal amount of converted Notes, as the case may be. The warrant transactions could separately have a dilutive effect to the extent that the market price per share of our common stock exceeds the strike price of the Warrants.

The option counterparties and/or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock in secondary market transactions prior to the maturity of the Notes (and are likely to do so during any observation period related to a conversion of Notes or following any repurchase of Notes by us on any fundamental change repurchase

date or otherwise). This activity could also cause or avoid an increase or a decrease in the market price of our common stock or the Notes, which could affect note holders' ability to convert the Notes and, to the extent the activity occurs during any observation period related to a conversion of Notes, it could affect the amount and value of the consideration that note holders will receive upon conversion of the Notes.

The potential effect, if any, of these transactions and activities on the market price of our common stock or the Notes will depend in part on market conditions and cannot be ascertained at this time. Any of these activities could adversely affect the value of our common stock and the value of the Notes (and as a result, the value of the consideration, the amount of cash and/or the number of shares, if any, that note holders would receive upon the conversion of any Notes) and, under certain circumstances, the ability of the note holders to convert the Notes.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the Notes or our common stock. In addition, we do not make any representation that the option counterparties will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.



***We are subject to counterparty risk with respect to the Note Hedge transactions.***

The option counterparties are financial institutions, and we will be subject to the risk that any or all of them may default under the Note Hedge transactions. Our exposure to the credit risk of the option counterparties will not be secured by any collateral. Recent global economic conditions have resulted in the actual or perceived failure or financial difficulties of many financial institutions. If an option counterparty becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings, with a claim equal to our exposure at that time under our transactions with that option counterparty. Our exposure will depend on many factors but, generally, an increase in our exposure will be correlated to an increase in the market price and in the volatility of our common stock. In addition, upon a default by an option counterparty, we may suffer adverse tax consequences and more dilution than we currently anticipate with respect to our common stock. We can provide no assurances as to the financial stability or viability of the option counterparties.

**Risks Related to Ownership of Our Common Stock**

***The market price of our common stock has historically been and is likely to continue to be volatile, could adversely impact the trading price of the Notes and could subject us to litigation.***

The trading price of our common stock has been, and is likely to continue to be, volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. In addition, the trading prices of the securities of technology companies in general have been highly volatile, and the volatility in market price and trading volume of securities is often unrelated or disproportionate to the financial performance of the companies issuing the securities. Factors affecting the market price of our common stock include:

- variations in our growth rate, operating results, earnings per share, cash flows from operating activities, deferred revenue, and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;
- forward-looking statements related to future revenues and earnings per share;
- the net increases in the number of customers, either independently or as compared with published expectations of industry, financial or other analysts that cover our company;
- changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;
- announcements of technological innovations, new solutions or enhancements to services, strategic alliances or significant agreements by us or by our competitors;
- our ability to expand our IT operations management, customer service and security incident management product offerings and the use of our platform for service management outside of enterprise IT;
- announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;
- announcements of customer additions and customer cancellations or delays in customer purchases;
- recruitment or departure of key personnel;
- disruptions in our services due to computer hardware, software or network problems, security breaches, or other man-made or natural disasters;
- the economy as a whole, and market conditions in our industry and the industries of our customers;
- trading activity by a limited number of stockholders who together beneficially own a majority of our outstanding common stock;
- the size of our market float and the volume of trading in our common stock, including sales upon exercise of outstanding options or vesting of equity awards or sales and purchases of any common stock issued upon conversion of the Notes or in connection with the Note Hedge and Warrant transactions relating to the Notes; and
- any other factors discussed herein.



In addition, if the market for technology 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 of our common 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. A decrease in the market price of our common stock would likely adversely impact the trading price of our Notes. The price of our common stock could also be affected by possible sales of our common stock by investors who view the Notes as a more attractive means of equity participation in us and by hedging or arbitrage trading activity that we expect to develop involving our common stock. This trading activity could, in turn, affect the trading price of the Notes. Some companies that have experienced volatility in the trading price of their stock have been the subject of securities class action litigation. If we are the subject of such litigation, it could result in substantial costs and a diversion of our management's attention and resources.

***We do not intend to pay dividends on our common stock so any returns will be limited to changes in the value of our common stock.***

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. In addition, our ability to pay cash dividends on our common stock may be prohibited or limited by the terms of any future debt financing arrangement. Any return to stockholders will therefore be limited to the increase, if any, of our stock price.

***Provisions in our charter documents, Delaware law and our Notes might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the market price of our common stock.***

Our restated certificate of incorporation and restated bylaws contain provisions that could depress the market price of our common stock by acting to discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions among other things:

- establish a classified board of directors so that not all members of our board are elected at one time;
- permit the board of directors to establish the number of directors;
- provide that directors may only be removed “for cause” and only with the approval of 66 2/3% of our stockholders;
- require super-majority voting to amend some provisions in our restated certificate of incorporation and restated bylaws;
- authorize the issuance of “blank check” preferred stock that our board could use to implement a stockholder rights plan;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our restated bylaws; and
- establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company. Section 203 imposes certain restrictions on merger, business combinations and other transactions between us and holders of 15% or more of our common stock.

Further, the fundamental change 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).



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

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS****EXHIBIT INDEX**

<u>Exhibit Number</u>	<u>Description of Document</u>	<u>Incorporated by Reference</u>		<u>Filed Herewith</u>
		<u>Form No.</u>	<u>File Exhibit</u>	
31.1	Certification of Periodic Report by Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002			X
31.2	Certification of Periodic Report by Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002			X
32.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			X
32.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			X
101.INS**	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL 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

\* The certifications on Exhibit 32 hereto are deemed not “filed” for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, or otherwise subject to the liability of that Section. Such certifications will not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act.



\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not “filed” for purposes of Sections 11 or 12 of the Securities Act, are deemed not “filed” for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under those Sections.

## **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.

### **SERVICENOW, INC.**

Date: November 4, 2016 By: /s/ Frank Sloomman  
Frank Sloomman  
*President and Chief Executive Officer*  
(On behalf of the Registrant)

Date: November 4, 2016 By: /s/ Michael P. Scarpelli  
Michael P. Scarpelli  
*Chief Financial Officer*  
(As Principal Financial and Accounting Officer)