FireEye, Inc.
Form 10-Q
November 14, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

or

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

For the transition period from to

Commission File Number 001-35594

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

Delaware (State or other jurisdiction of incorporation or organization)	20-1548921 (I.R.S. Employer Identification Number)

1440 McCarthy Blvd.
Milpitas, CA 95035
(408) 321-6300
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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 x

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

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

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

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

The number of shares of the registrant's common stock outstanding as of October 31, 2013 was 120,822,637.

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PART I — FINANCIAL INFORMATION
Item1. Financial Statements
FIREEYE, INC.
Condensed Consolidated Balance Sheets
(In thousands, except per share data)
(Unaudited)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 327,710	$ 60,200
Accounts receivable	51,251	30,133
Inventories	7,516	2,340
Deferred costs of revenue, current portion	1,392	837
Prepaid expenses and other current assets	9,319	10,731
Total current assets	397,188	104,241
Deferred costs of revenue, non-current portion	1,024	674
Property and equipment, net	47,131	13,536
Goodwill	3,276	1,274
Intangible assets	6,809	4,194
Deposits and other long-term assets	4,877	1,354
TOTAL ASSETS	$ 460,305	$ 125,273
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 32,983	$ 15,653
Accrued liabilities	4,896	1,174
Accrued compensation	14,818	8,271
Long-term debt, current portion	—	1,231
Proceeds from early exercise of stock awards	8,623	2,001
Deferred revenue, current portion	71,450	43,750
Total current liabilities	132,770	72,080
Long-term debt, net of current portion	20,000	10,916
Deferred revenue, non-current portion	59,302	32,656
Preferred stock warrant liability	—	3,529
Other long-term liabilities	1,246	702
Total liabilities	213,318	119,883
Commitments and contingencies (NOTE 7)		
Stockholders' equity:		
Convertible preferred stock, par value of $0.0001 per share; no shares authorized, issued, and outstanding as September 30 2013; 65,326 shares authorized, 64,115 issued and outstanding with liquidation preference of $96,746 as of December 31, 2012	—	6
Common stock, par value of $0.0001 per share; 1,000,000 shares authorized, 120,517 shares issued and outstanding as of September 30, 2013; 130,000 authorized, 22,435 shares issued and outstanding as of December 31, 2012	12	2
Additional paid-in capital	467,964	109,252
Notes receivable from stockholders	—	(1,003)
Accumulated deficit	(220,989)	(102,867)

Total stockholders’ equity	246,987	5,390
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$ 460,305	$ 125,273

See accompanying notes to the condensed consolidated financial statements.

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FIREEYE, INC.
Condensed Consolidated Statements of Operations
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue:				
Product	$23,729	$13,754	$55,957	$31,955
Subscription and services	18,923	8,142	48,333	19,682
Total revenue	42,652	21,896	104,290	51,637
Cost of revenue:				
Product	7,358	3,813	18,124	9,400
Subscription and services	6,079	904	12,481	2,183
Total cost of revenue	13,437	4,717	30,605	11,583
Total gross profit	29,215	17,179	73,685	40,054
Operating expenses:				
Research and development	20,492	4,191	44,570	9,814
Sales and marketing	44,414	16,734	110,577	42,788
General and administrative	11,704	4,188	29,385	8,898
Total operating expenses	76,610	25,113	184,532	61,500
Operating loss	(47,395)	(7,934)	(110,847)	(21,446)
Interest income	1	2	53	5
Interest expense	(243)	(167)	(519)	(377)
Other expense, net	(4,206)	(699)	(7,129)	(1,248)
Loss before income taxes	(51,843)	(8,798)	(118,442)	(23,066)
Provision for (benefit from) income taxes	(917)	54	(320)	114
Net loss attributable to common stockholders	$(50,926)	$(8,852)	$(118,122)	$(23,180)
Net loss per share attributable to common stockholders, basic and diluted	$(1.61)	$(0.80)	$(5.41)	$(2.33)
Weighted average shares used in computing net loss per share attributable to common stockholders, basic and diluted	31,590	11,025	21,838	9,955

See accompanying notes to the condensed consolidated financial statements.

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FIREEYE, INC.
Condensed Consolidated Statement of Stockholders' Equity
(Unaudited, in thousands)

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Notes Receivable from Stockholders	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance at December 31, 2012	64,115	$6	22,435	$2	$109,252	$ (1,003)	$ (102,867)	$ 5,390
Issuance of common stock in connection with initial public offering, net of offering costs			17,450	2	321,278			321,280
Conversion of convertible preferred stock to common stock in connection with initial public offering	(64,590)	(6)	74,222	7	(1)			—
Conversion of preferred stock warrant to common stock warrant in connection with initial public offering					10,067			10,067
Issuance of common stock related to the acquisition of Secure DNA Managed Services, Inc.			50	—	800			800
Payment of note receivable from stockholder, net of early exercises					828	1,003		1,831
Net proceeds from issuance of Series F convertible preferred stock	475				4,994			4,994
Issuance of common stock for equity awards, net of repurchases			6,360	1	2,530			2,531
Vesting of early exercise of equity awards					1,872			1,872
Stock-based compensation					16,344			16,344
Net loss							(118,122)	(118,122)
Balance at September 30, 2013	—	$—	120,517	$12	$467,964	$ —	$ (220,989)	$ 246,987

See accompanying notes to the condensed consolidated financial statements.

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FIREEYE, INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited, in thousands)

	Nine Months Ended September 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(118,122)	$(23,180)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	12,344	4,456
Stock-based compensation	16,344	3,921
Change in fair value of preferred stock warrant liability	6,538	1,234
Loss on disposal of property and equipment	102	73
Release of deferred tax valuation allowance	(1,277)	—
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Accounts receivable	(20,727)	(5,607)
Inventories	(5,174)	(1,942)
Prepaid expenses and other assets	(4,772)	(790)
Deferred costs of revenue	(904)	(695)
Accounts payable	6,115	990
Accrued liabilities	3,711	2,198
Accrued compensation	6,481	372
Deferred revenue	54,370	29,481
Other long-term liabilities	547	134
Net cash provided by (used in) operating activities	(44,424)	10,645
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of business, net of cash acquired	(3,872)	—
Purchase of property and equipment and demonstration units	(35,956)	(14,486)
Lease deposits	(1,636)	(471)
Net cash used in investing activities	(41,464)	(14,957)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from initial public offering	322,863	—
Borrowing from line of credit	10,000	7,619
Net proceeds from issuance of convertible preferred stock	9,988	—
Repayment of term loan	(2,147)	(1,051)
Proceeds from exercise of equity awards	5,400	1,283
Repayment of notes receivable from stockholders	7,294	—
Net cash provided by financing activities	353,398	7,851
Net change in cash and cash equivalents	267,510	3,539
Cash and cash equivalents, beginning of year	60,200	10,676
Cash and cash equivalents, end of year	$327,710	$14,215
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	$493	$347
Cash paid for income taxes	$303	$22
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Deferred initial public offering costs in accounts payable and accrued liabilities	$1,583	$—

Common stock issued in connection with acquisition	$800	$—
Conversion of preferred stock warrants to common stock warrants	$10,067	$—
Purchases of property and equipment and demonstration units in accounts payable	$12,520	$1,127

See accompanying notes to the condensed consolidated financial statements.

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FIREEYE, INC.
Notes to Condensed Consolidated Financial Statements

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

FireEye, Inc., with principal executive offices located in Milpitas, California, was incorporated as NetForts, Inc. on February 18, 2004, under the laws of the State of Delaware, and changed its name to FireEye, Inc. on September 7, 2005.

FireEye, Inc. and its wholly owned subsidiaries (collectively, the "Company", "we", "us" or "our") is a leader in stopping advanced cyber attacks that use advanced malware, zero-day exploits, and APT ("Advances Persistent Threat") tactics. Our solutions supplement traditional and next-generation firewalls, IPS ("Intrusion Prevention Systems"), anti-virus, and gateways, which cannot stop advanced threats, leaving security holes in networks. We offer a solution that detects and blocks attacks across both Web and email threat vectors as well as latent malware resident on file shares. It addresses all stages of an attack lifecycle with a signature-less engine utilizing stateful attack analysis to detect zero-day threats.

We sell the majority of our products, subscriptions and services to end-customers through distributors, resellers, and strategic partners, with a lesser percentage of sales directly to end-customers.

Initial Public Offering

In September 2013, we completed our initial public offering ("IPO") in which we issued and sold 17,450,000 shares of common stock (inclusive of 2,275,000 shares of common stock from the full exercise of the over-allotment option granted to the underwriters) at a price of $20.00 per share. We received aggregate proceeds of $324.6 million from the sale of shares of common stock, net of underwriters' discounts and commissions, but before deducting paid and unpaid offering expenses of approximately $3.3 million. Upon the closing of the initial public offering, all shares of our outstanding convertible preferred stock automatically converted into 74,221,533 shares of common stock.

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of FireEye, Inc., and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), and following the requirements of the Securities and Exchange Commission ("SEC"), for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by U.S. GAAP can be condensed or omitted. These financial statements have been prepared on the same basis as our annual financial statements and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, that are necessary for a fair statement of our financial information. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013 or for any other interim period or for any other future year. The balance sheet as of December 31, 2012 has been derived from audited financial statements at that date but does not include all of the information required by U.S. GAAP for complete financial statements.

The accompanying condensed consolidated financial statements and related financial information should be read in conjunction with the audited financial statements and the related notes thereto for the year ended December 31, 2012 included in our Prospectus filed with the SEC on September 20, 2013 pursuant to Rule 424(b) under the Securities Act of 1933, as amended (the "Securities Act").

Use of Estimates

The preparation of consolidated financial statements in conformity U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Such management estimates include, but are not limited to, the best estimate of selling price for our products and services, commissions expense,
future taxable income, contract manufacturer liabilities, litigation and settlement costs and other loss contingencies, fair value of our common and preferred stock, stock options and preferred stock warrant liability, and the purchase price allocation of acquired businesses. We base our estimates on historical experience and also on assumptions that we believe are reasonable. Changes in facts or circumstances may cause us to change our assumptions and estimates in future periods and it is possible that actual results could differ from current or revised future estimates. We engaged third party consultants to assist management in the valuation of acquired assets, including other intangibles.

Summary of Significant Accounting Policies

There have been no material changes to our significant accounting policies as compared to the those described in our Prospectus filed with the SEC on September 20, 2013 pursuant to Rule 424(b) under the Securities Act as disclosed below.

Fair Value of Financial Instruments

We define fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities which are required to be recorded at fair value, we consider the principal or most advantageous market in which to transact and the market-based risk. We apply fair value accounting for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The carrying amounts reported in the condensed consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, due to their short-term nature. The carrying amount of our preferred stock warrant liability represents their fair value and the long term debt is stated at the carrying value which approximates fair value as the stated interest rate approximates market borrowing rates currently available to us.

Warranties

We generally provide a one-year warranty on hardware. We do not accrue for potential warranty claims as a component of cost of product revenue as all product warranty claims are satisfied under our support and maintenance contracts.

Revenue Recognition

We generate revenue from the sales of products, subscriptions, support and maintenance, and other services primarily through our indirect relationships with our partners as well as end customers through a direct sales force. Our products include operating system software that is integrated into the appliance hardware and is deemed essential to its functionality. As a result, we account for revenue in accordance with Accounting Standards Codification 605, Revenue Recognition, and all related interpretations, as all our security appliance deliverables include proprietary operating system software, which together deliver the essential functionality of our products.

Revenue is recognized when all of the following criteria are met:

- Persuasive Evidence of an Arrangement Exists. We rely upon non-cancelable sales agreements and purchase orders to determine the existence of an arrangement.

- Delivery has Occurred. We use shipping documents or transmissions of service contract registration codes to verify delivery.

- The Fee is Fixed or Determinable. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction.

- Collectability is Reasonably Assured. We assess collectability based on credit analysis and payment history.

Our products include three principal security product families that address critical vectors of attack, including Web, email and file shares. Our Web MPS, File MPS, MAS and CMS appliance and subscription services qualify as separate units of accounting. Therefore, Web MPS, File MPS, MAS and CMS appliance product revenue is recognized at the time of shipment. However, our Email MPS cannot function without the use of our subscription services. As such, our Email MPS products and related services do not have stand-alone value and do not qualify as separate units of accounting. Therefore, Email MPS product revenue is recognized ratably over the longer of the contractual term of the subscription services or the estimated period the customer is expected to benefit from the product, provided that all other revenue recognition criteria have been met. Because we have only been selling our Email MPS since April 2011, we have a limited history with respect to subscription renewals for such product. As a result, revenue from all Email MPS products sold by us through September 30, 2013 has been recognized ratably over the contractual term of the subscription services.

At the time of shipment, product revenue meets the criteria for fixed or determinable fees. In addition, payment from our partners is not contingent on the partner’s collection from their end-customers. Our partners do not stock products and do not have any stock rotation rights. We recognize subscription and support and maintenance service revenue ratably over the contractual service period, which is typically one or three years. Other services revenue is recognized as the services are rendered and has not been significant to date.

Most of our arrangements, other than renewals of subscriptions and support and maintenance services, are multiple-element arrangements with a combination of product, subscriptions, support and maintenance, and other services. For multiple-element arrangements, we allocate revenue to each unit of accounting based on an estimated selling price at the arrangement inception. The estimated selling price for each element is based upon the following hierarchy: vendor-specific objective evidence (“VSOE”) of selling price, if available, third-party evidence (“TPE”) of selling price, if VSOE of selling price is not available, or best estimate of selling price (“BESP”), if neither VSOE of selling price nor TPE of selling price are available. The total arrangement consideration is allocated to

each separate unit of accounting using the relative estimated selling prices of each unit based on the aforementioned selling price hierarchy. We limit the amount of revenue recognized for delivered elements to an amount that is not contingent upon future delivery of additional products or services or meeting of any specified performance conditions.

To determine the estimated selling price in multiple-element arrangements, we seek to establish VSOE of selling price using the prices charged for a deliverable when sold separately and, for subscriptions and support and maintenance, based on the renewal rates and discounts offered to partners. If VSOE of selling price cannot be established for a deliverable, we seek to establish TPE of selling price by evaluating similar and interchangeable competitor products or services in standalone arrangements with similarly situated partners. However, as our products contain a significant element of proprietary technology and offer substantially different features and functionality from our competitors, we are unable to obtain comparable pricing of our competitors' products with similar functionality on a standalone basis. Therefore, we have not been able to obtain reliable evidence of TPE of selling price. If neither VSOE nor TPE of selling price can be established for a deliverable, we establish BESP primarily based on historical transaction pricing. Historical transactions are segregated based on our pricing model and our go-to-market strategy, which include factors such as type of sales channel (reseller, distributor, or end-customer), the geographies in which our products and services were sold (domestic or international), offering type (products, subscriptions or services), and whether or not the opportunity was identified by our sales force or by our partners. In analyzing historical transaction pricing, we evaluate whether a majority of the prices charged for a product, as represented by a percentage of list price, fall within a reasonable range. To further support the best estimate of selling price as determined by the historical transaction pricing or when such information is unavailable, such as when there are limited sales of a new product, we consider the same factors we have established through our pricing model and go-to-market strategy. The determination of BESP is made through consultation with and approval by our management. We have established the estimated selling price of all of our deliverables using BESP.

Shipping charges billed to partners are included in revenue and related costs are included in cost of revenue. Sales commissions and other incremental costs to acquire contracts are also expensed as incurred and are recorded in sales and marketing expense. After receipt of a partner order, any amounts billed in excess of revenue recognized are recorded as deferred revenue.

Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board, ("FASB") issued authoritative guidance that addresses the presentation of comprehensive income for annual reporting of financial statements was issued. The guidance is intended to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. Such components of comprehensive income will be required to be disclosed in either a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance is effective for fiscal years beginning after December 15, 2011, and should be applied retrospectively for all periods presented. Early adoption is permitted. This new guidance impacts how we report comprehensive income, and did not have any effect on our results of operations, financial position or liquidity upon its required adoption on January 1, 2012.

In February 2013, the FASB issued guidance which addresses the presentation of amounts reclassified from accumulated other comprehensive income. This guidance does not change current financial reporting requirements, instead an entity is required to cross-reference to other required disclosures that provide additional detail about amounts reclassified out of accumulated other comprehensive income. In addition, the guidance requires an entity to present significant amounts reclassified out of accumulated other comprehensive income by line item of net income if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. Adoption of this standard is required for periods beginning after December 15, 2012 for public companies. This new guidance impacts how we report comprehensive income and has no material effect on our results of operations,

financial position or liquidity upon its required adoption on January 1, 2013.

2. Fair Value Measurements

We categorize assets and liabilities recorded at fair value on our condensed consolidated balance sheets based upon the level of judgment associated with inputs used to measure their fair value. The categories are as follows:

- Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2—Inputs are quoted prices for similar assets and liabilities in active markets or inputs other than quoted prices that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.

- Level 3—Inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. The inputs require significant management judgment or estimation.

The following table presents the fair value of our financial assets and liabilities using the above input categories (in thousands):

	As of September 30, 2013			
Description	Level 1	Level 2	Level 3	Fair Value
Money market funds	$300,000	$—	$—	$300,000
Total assets measured at fair value	$300,000	$—	$—	$300,000

	As of December 31, 2012			
Description	Level 1	Level 2	Level 3	Fair Value
Money market funds	$5,893	$—	$—	$5,893
Preferred stock warrant liability	—	—	3,529	3,529
Total assets and liabilities measured at fair value	$5,893	$—	$3,529	$9,422

Level 1 investments consist solely of money market funds, included in cash and cash equivalents, valued at amortized cost which approximates fair value. Level I liabilities consist of long-term debt. Level 3 instruments consist solely of our preferred stock warrant liability in which the fair value was measured upon issuance and at each period end. Inputs used to determine the estimated fair value of the warrant liability as of the valuation date included remaining contractual term of the warrants, the risk-free interest rate, volatility of our comparable public companies over the remaining term, and the fair value of underlying shares. The significant unobservable inputs used in the fair value measurement of the preferred stock warrant liability were the fair value of the underlying stock at the valuation date and the estimated term of the warrants. Generally, increases (decreases) in the fair value of the underlying stock and estimated term would result in a directionally similar impact to the fair value measurement.

The following table sets forth a summary of the changes in the fair value of our Level 3 financial instruments as follows
(in thousands):

	Preferred Stock Warrant Liability
Balance as of December 31, 2012	$3,529
Change in fair value of preferred stock warrant liability	6,538
Reclassification of preferred stock warrants to common stock warrants upon IPO	(10,067)
Balance as of September 30, 2013	$—

The gains and losses from remeasurement of Level 3 financial liabilities are recorded in other expenses, net in the Condensed Consolidated Statements of Operations.

3. Property and Equipment

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

	As of September 30, 2013	As of December 31, 2012
Computer equipment, and software	$40,264	$12,115
Leasehold improvements	11,171	2,668
Furniture and fixtures	5,357	1,841
Total property and equipment	56,792	16,624
Less: accumulated depreciation	(9,661)	(3,088)
Total property and equipment, net	$47,131	$13,536

Depreciation and amortization expense related to property and equipment and demonstration units during the three months ended September 30, 2013 and 2012 was $4.9 million and $2.3 million, respectively. Depreciation and amortization expense related to property and equipment and demonstration units during the nine months ended September 30, 2013 and 2012 was $11.5 million and $4.5 million, respectively.

4. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2013 are as following (in thousands):

Balance as of December 31, 2012	$1,274
Goodwill acquired	2,002
Balance as of September 30, 2013	$3,276

Intangible assets consist of the following (in thousands):

	As of September 30, 2013	As of December 31, 2012
Developed technology	$5,794	$4,194
Customer relationships	1,900	—
Less: accumulated amortization	(885)	—
Net acquired intangible assets	$6,809	$4,194

The developed technology will be amortized to cost of sales over the economic life of the related technology asset which was estimated to be three to four years as of the acquisition date. The customer relationships will be amortized to sales and marketing expense over the economic life of the related customer relationship asset which was estimated to be three years as of the acquisition date. Amortization expense of intangible assets for the three months ended September 30, 2013 and 2012 was $0.4 million and zero, respectively. Amortization expense of intangible assets for the nine months ended September 30, 2013 and 2012 was $0.9 million and zero, respectively.

The expected annual amortization expense of intangible assets as of September 30, 2013 is presented below (in thousands):

Years Ending December 31,	Intangible Assets
2013 (remaining three months)	$553
2014	2,215
2015	2,215

2016	1,826
Total intangible assets subject to amortization	$6,809

On September 3, 2013, we acquired all outstanding shares of Secure DNA Managed Services, Inc. and certain affiliated entities (collectively, “Secure DNA”), a security solutions provider based in Honolulu, Hawaii, focused on network monitoring and

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management, secured hosting, cloud e-mail protection, incident response and other network security related services. The acquisition of Secure DNA provides us with the developed technology platform that will facilitate the delivery of the advanced security services for all our products.

We accounted for the acquisition of Secure DNA as a purchase of a business. We expensed the related acquisition costs, consisting primarily of legal expenses in the amount of $0.2 million, and these expenses were presented as general and administrative expenses on the condensed consolidated statements of operations for the three and nine months ended September 30, 2013. The total purchase consideration of $4.9 million consisted of $4.1 million in cash and the issuance of 50,000 shares of our common stock with a fair value of $16.00 per share on the acquisition date. We also assumed deferred tax liabilities related to the fair value of the developed technology and customer relationships we obtained in the acquisition as well as other assumed liabilities related to normal operations. Primarily as a result of the deferred tax liabilities assumed in the acquisition, we recognized goodwill of $2.0 million equal to the excess of the purchase consideration over the fair value of the assets acquired and the liabilities assumed. None of the goodwill is expected to be deductible for income tax purposes.

The acquisition also includes a contingent obligation of up to $3.0 million, consisting of 190,000 shares of our common stock with a fair value of $16.00 per share on the acquisition date, to certain employees from Secure DNA, if specified product and service milestones are met within the two years of the acquisition date. As the obligation is contingent upon their continuous employment with us, the contingent obligation is being recorded as compensation expense ratably over the respective service periods.

The following table summarizes the consideration paid and the fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Consideration:	Amount	
Developed technology	$1,600	
Customer relationships	1,900	
Deferred tax liabilities	(1,290	)
Net assets acquired	665	
Goodwill	2,002	
Fair value of total consideration transferred	$4,877	

The results of operations of Secure DNA have been included in our condensed consolidated statements of operations from the acquisition date. Pro forma results of operations have not been presented because the acquisition was not material to our results of operations.

5. Deferred Revenue

Deferred revenue consists of the following (in thousands):

	As of September 30, 2013	As of December 31, 2012
Product, current	$11,019	$6,570
Subscription and services, current	60,431	37,180
Total deferred revenue, current	71,450	43,750
Product, non-current	5,730	3,888
Subscription and services, non-current	53,572	28,768
Total deferred revenue, non-current	59,302	32,656
Total deferred revenue	$130,752	$76,406

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6. Long-term Debt

In August 2005, we entered into a loan agreement (the "First Loan Agreement") with two lenders that provided for borrowings under an equipment facility and a growth capital facility. The First Loan Agreement provided for advances under the equipment facility up to $1.0 million in $50,000 increments through the termination date on December 31, 2006 and advances under the growth capital facility up to $3.0 million in $1.0 million increments through the termination date on December 31, 2006. Outstanding borrowings under the equipment facility were due in 36 equal monthly payments of principal and interest following the month of borrowing, with a final payment on the maturity date equal to 2.5% of the drawn down principal. Outstanding borrowings under the growth capital facility were due in 36 monthly payments of principal and interest beginning January 1, 2007. There were no amounts outstanding under the First Loan Agreement as of December 31, 2011 and 2012 and September 30, 2013. We did issue certain convertible preferred stock warrants in association with these loans which are discussed in note 8.
In June 2010, the Company entered into a second loan agreement (the "Second Loan Agreement") with a lender that provides for: (1) a revolving line of credit facility, (2) an equipment facility and (3) a term loan. In addition, this loan agreement was amended in August 2011 to provide for additional borrowings under a (4) growth facility. The Second Loan Agreement provides certain financial-related covenants. We were in compliance with all financial-related covenants under the Second Loan Agreement as of December 31, 2012 and September 30, 2013.

Line of Credit

In December 2012, the Second Loan Agreement was amended to increase the amounts available under the line of credit to $25.0 million, extend the maturity date to December 31, 2014 and add a supplemental equipment line of $15.0 million, which has a maturity date in September 2016. Borrowings under the line of credit were collateralized by all of the Company's assets, excluding intellectual property, and the availability of borrowings under the line of credit were subject to certain borrowing base limitations around our outstanding accounts receivable. As of September 30, 2013 and December 31, 2012, there were no amounts outstanding under the supplemental equipment line. We drew down $7.6 million under the line of credit during the year ended December 31, 2012. We drew down $10.0 million under the line of credit during the nine months ended September 30, 2013. Borrowings under the revolving line of credit consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Second Loan Agreement—revolving line of credit	$20,000	$10,000
Less current portion	—	—
Total	$20,000	$10,000

Term Loans

Outstanding borrowings under our debt agreements consist of the following (in thousands):

	December 31, 2012
Second Loan Agreement—equipment facility	$132
Second Loan Agreement—growth capital facility	1,832
Second Loan Agreement—term loan	183
	2,147
Less current portion	(1,231)
Total	$916

We paid off the balances of the term loans during the nine months ended September 30, 2013.

7. Commitments and Contingencies

Leases

We lease our facilities under various non-cancelable operating leases, which expire through the year ending December 31, 2017. Rent expense is recognized using the straight-line method over the term of the lease. Rent expense was $1.0 million and $0.2 million for the three months ended September 30, 2013 and 2012; $2.5 million and $0.5 million for the nine months ended September 30, 2013 and 2012.

The aggregate future non-cancelable minimum rental payments on our operating leases, as of September 30, 2013, are as follows (in thousands):

Years Ending December 31,	Amount
2013 (remaining 3 months)	$1,701
2014	6,762
2015	5,961
2016	3,616
2017 and thereafter	3,111
Total	$21,151

Contract Manufacturer Commitments

Our independent contract manufacturer procures components and assembles our products based on our forecasts. These forecasts are based on estimates of future demand for our products, which are in turn based on historical trends and an analysis from our sales and product marketing organizations, adjusted for overall market conditions. In order to reduce manufacturing lead times and plan for adequate supply, we may issue forecasts and orders for components and products that are non-cancelable. As of September 30, 2013 and December 31, 2012, we had $17.7 million and $3.3 million of non-cancellable open orders, respectively. As of September 30, 2013 and December 31, 2012, we have not accrued any significant cost associated with the excess of our forecasted demand including costs for excess components or for carrying costs incurred by our independent contract manufacturer.

Litigation

We accrue for contingencies when we believe that a loss is probable and that we can reasonably estimate the amount of any such loss. We have made an assessment of the probability of incurring any such losses and whether or not those losses are estimable.

We are subject to legal proceedings, claims and litigation, including intellectual property litigation, arising in the ordinary course of business. Such matters are subject to many uncertainties and outcomes and are not predictable with assurance. We accrue amounts that we believe are adequate to address any liabilities related to legal proceedings and other loss contingencies that we believe will result in a probable loss that is reasonably estimable.

To the extent there is a reasonable possibility that a loss exceeding amounts already recognized may be incurred and the amount of such additional loss would be material, we will either disclose the estimated additional loss or state that such an estimate cannot be made. We do not currently believe that it is reasonably possible that additional losses in connection with litigation arising in the ordinary course of business would be material.

Indemnification

Under the indemnification provisions of our standard sales related contracts, we agree to defend our customers against third-party claims asserting infringement of certain intellectual property rights, which may include patents, copyrights, trademarks, or trade secrets, and to pay judgments entered on such claims. Our exposure under these indemnification provisions is generally limited to the total amount paid by our customer under the agreement. However, certain agreements include indemnification provisions that could potentially expose us to losses in excess of the amount received under the agreement. In addition, we indemnify our officers, directors, and certain key employees while they are serving in good faith in their company capacities. Through September 30, 2013, there have been no claims under any indemnification provisions.

8. Convertible Preferred Stock Warrants

In connection with the First Loan Agreement and Second Loan Agreement entered into or amended during the years ended December 31, 2005, 2006, 2007, 2008, 2011 and 2012 (Note 6), we issued warrants to purchase an aggregate of 525,502 shares of convertible preferred stock, all of which were exercisable upon issuance. As of September 19, 2013, the day prior to the date on which our shares began to trade publicly, and December 31, 2012, all of the convertible preferred stock warrants remained outstanding as follows (in thousands, except share and per share amounts):

Class of Shares	Issuance Date(s)	Expiration Date(s)	No. of Shares	Exercise Price per Share	As of September 19, 2013	As of December 31, 2012
Series A-2	2005 and 2006	2015 and 2016	245,899	$0.61	$4,758	$ 1,632
Series B	2006 through 2008	2016 through 2018	118,942	$1.32	2,220	925
Series D	June 2010	June 2020	100,000	$0.39	1,959	634
Series E	August 2011	August 2021	60,661	$1.36	1,130	338
Total					$10,067	$ 3,529

Prior to our IPO, the fair value of the warrants was recorded as a warrant liability. The warrant was recorded at its estimated fair value with changes in the fair value of the warrant liability reflected in other expense, net. Upon the completion of our IPO, the shares underlying the warrants were converted from warrants to purchase preferred stock into warrants to purchase approximately 616,000 shares of common stock, and the related balance of the preferred stock warrant liability was reclassified to additional paid-in capital.

We recognized charges of $3.6 million and $0.7 million for the three months ended September 30, 2013 and 2012, respectively, and $6.5 million and $1.2 million for the nine months ended September 30, 2013 and 2012, respectively. These charges are from the remeasurement of the fair value of the warrant liability, which was recorded through other expense, net in the condensed consolidated statements of operations.

The value of the underlying warrants were determined using appropriate valuation techniques at September 19, 2013 and December 31, 2012 using the following assumptions:

	As of September 19, 2013	As of December 31, 2012
Remaining contractual term (in years)	0.5	2.6 – 8.7
Risk-free interest rate	0.03%	0.3% –1.5%
Volatility	42.8%	55% – 64%
Change of control probability	–	25% – 50%
Control premium	–	40%
IPO threshold (in billions)	–	$0.6 – $1.8

9. Convertible Preferred Stock

Immediately prior to the completion of our IPO on September 19, 2013, we had the following redeemable convertible preferred stock outstanding, all of which was converted to common stock in connection with our IPO (in thousands):

	September 19, 2013			December 31, 2012		
	Shares Designated	Shares Issued and Outstanding	Liquidation Preference	Shares Designated	Shares Issued and Outstanding	Liquidation Preference
Series A-1	1,000	1,000	$ 250	1,000	1,000	$250
Series A-2	10,410	10,164	6,200	10,410	10,164	6,200
Series B	11,104	10,985	14,500	11,104	10,985	14,500
Series C	7,049	7,049	14,604	7,049	7,049	14,604
Series D	26,331	26,231	10,187	26,331	26,231	10,187
Series E	4,632	4,412	6,000	4,632	4,412	6,000
Series F	4,800	4,749	49,999	4,800	4,274	45,005
Total	65,326	64,590	$ 101,740	65,326	64,115	$96,746

Significant terms of the convertible preferred stock were as follows:

Voting Rights

The holders of the convertible preferred stock were entitled to one vote for each share of common stock into which their shares of convertible preferred stock would have been converted and the holders of the convertible preferred stock and common stock would have voted together on an as converted basis. For the election of the Directors, and as long as 1,000,000 shares of convertible preferred stock were outstanding, the holders of the Series A-1, A-2, B, C, D and E convertible preferred stock could have elected two Directors. The holders of the common stock could have elected two Directors. A majority of the preferred stock (other than Series F convertible preferred stock) and common stock (each voting as a separate class) would have been required to elect any remaining directors. The holders of the Series F convertible preferred stock did not have voting rights with respect to the election of Directors.

Dividends

The holders of the convertible preferred stock were entitled, when, as, and if declared by the Board of Directors, and prior and in preference to common stock, to non-cumulative dividends at the following per annum rates; $0.015 per share for Series A-1, $0.0366 per share for Series A-2, $0.0792 per share for Series B, $0.1243 per share for Series C, $0.0233014 per share for Series D, $0.0816 per share for Series E and $0.6318 per share for Series F. There were no cumulative preferred stock dividends in arrears as of September 30, 2013 and December 31, 2012. No dividends have been paid to date.

Liquidation

In the event of any voluntary or involuntary liquidation, dissolution, or winding up of our operations, all assets available for distribution would have been distributed to the holders of convertible preferred stock based on the original issue price of the related shares as follows: $0.25 per share for Series A-1, $0.61 per share for Series A-2, $1.32 per share for Series B, $2.0717 per share for Series C, $0.3883572 per share for Series D, $1.36 per share for Series E, and $10.5294 per share for Series F; plus all declared and unpaid dividends. If the available funds were insufficient to permit full payment of each Series' original issue price, the available funds would have been allocated based on the number of shares of convertible preferred stock outstanding on a pro-rata basis. Any remaining available funds after payment to the holders of the convertible preferred stock would have been distributed to holders of common stock on a pro-rata basis, except that if the holder of convertible preferred stock would have received more funds had they converted into common stock, then the holders of convertible preferred stock would have received the amount they would have received had they converted to common stock.

Conversion

Shares of convertible preferred stock were convertible, at any time and at the option of the holder, into shares of common stock. Shares of convertible preferred stock automatically convert into shares of common stock upon the closing of an IPO provided the aggregate proceeds from an IPO are not less than $75 million. As of September 19, 2013 and December 31, 2012, the conversion ratio for all series of convertible preferred stock was as follows; 1:1 for Series A-1, 1:1.1730769 for Series A-2, 1:1.4012739 for Series B, 1:1.4915047 for Series C, 1:1 for Series D and 1:1 for Series E. As of September 30, 2013, the conversion ratio for the Series F convertible preferred stock was 1:1. Shares of preferred stock were automatically converted to commons stock just prior to the closing of our initial public offering in September 2013 as the aggregate proceeds from the initial public offering exceeded $75 million.

Redemption

The convertible preferred stock was not redeemable.

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10. Common Shares Reserved for Issuance

We were authorized to issue 1,000,000,000 and 130,000,000 shares, respectively, of common stock with a par value of $0.0001 per share as of September 30, 2013 and December 31, 2012. Each share of common stock is entitled to one vote. The holders of common stock are also entitled to receive dividends whenever funds are legally available and when declared by the Board of Directors, subject to the prior rights of holders of all classes of convertible preferred stock outstanding.

As of September 30, 2013 and December 31, 2012, we reserved shares of common stock for issuance as follows (in thousands):

	As of September 30, 2013	As of December 31, 2012
Reserved under stock award plans	35,668	21,443
Conversion of preferred stock	—	73,747
Warrants to purchase convertible preferred stock	—	616
Warrants to purchase common stock	616	—
Total	36,284	95,806

11. Share Based Awards

Stock Option and Restricted Stock Plans

We have operated under three equity award plans, our 2004 Stock Option Plan (“2004 Plan”), our 2008 Stock Plan (“2008 Plan”), and our 2013 Equity Incentive Plan (“2013 Plan”) (collectively, the “Plans”), which were adopted by the Board of Directors and approved by the stockholders in August 2004, February 2008 and August 2013, respectively.

Our 2008 Plan and 2013 Plan provide for the issuance of restricted stock and the granting of options and restricted stock units to our employees, officers, directors, and consultants. Our 2004 Plan only allowed for the issuance of stock options. Awards granted under the Plans vest over the periods determined by the Board of Directors, generally four years, and expire no more than ten years after the date of grant. In the case of an incentive stock option granted to an employee who at the time of grant owns stock representing more than 10% of the total combined voting power of all classes of stock, the exercise price shall be no less than 110% of the fair value per share on the date of grant, and expire five years from the date of grant. For all other options granted, the per share exercise price shall be no less than 100% of the fair value per share on the date of grant. Stock that is purchased prior to vesting is subject to our right of repurchase at any time following termination of the participant.

We terminated our 2004 Plan in 2008 and terminated our 2008 Plan upon the completion of our IPO. Awards that were outstanding upon termination remained outstanding pursuant to their original terms. A total of 12,821,535 shares of our common stock are reserved for issuance pursuant to the 2013 Plan and includes shares that were reserved but unissued under the 2008 Plan.

2013 Employee Stock Purchase Plan

In August 2013, our board of directors adopted, and our stockholders approved, our 2013 Employee Stock Purchase Plan, or the "Purchase Plan". The Purchase Plan became effective upon adoption.

The Purchase Plan allows eligible employees to acquire shares of our common stock at 85% of the lower of the fair market value of our common stock on the first trading of each offering period or on the exercise date. Each offering period will be approximately twelve months starting on the first trading date on or after May 15 and November 15 of each year, except for the first offering period, which commenced on September 19, 2013 and will end on the first trading day on or after May 15, 2014. Participants may purchase shares of common stock through payroll deduction of up to 15% of their eligible compensation, subject to purchase limits of 3,000 shares for each normal purchase period or $25,000 worth of stock for each calendar year.

A total of 2,500,000 shares of our common stock is available for sales under the Purchase Plan. In addition, our Purchase Plan provides for annual increases in the number of shares available for issuance on the first day of each fiscal year beginning in 2014, equal to the lessor of: 1% of the outstanding shares of our common stock on the first day of such fiscal year; 3,700,000 shares; or such other amount as may be determined by our board of directors.

Stock Options Awards

A summary of the activity for our stock option changes during the reporting periods and a summary of information related to options exercisable, vested, and expected to vest are presented below (in thousands, except per share and contractual life amounts):

		Options Outstanding			
	Shares Available for Grant	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Contractual Life (years)	Aggregate Intrinsic Value
Balance—December 31, 2012	4,107	17,336	$ 0.98	8.28	$ 77,250
Additional shares authorized	20,413	—			
Restricted stock awards and units granted	(659)	—			
Options granted	(12,754)	12,754	8.57		
Options exercised	—	(6,207)	0.88		
Options canceled	1,176	(1,176)	2.88		
Unvested stock and restricted stock units forfeited	172	—			
Balance—September 30, 2013 (unaudited)	12,455	22,707	$ 5.17	8.72	$ 825,614
Options vested and expected to vest—September 30, 2013		19,600	$ 5.11	8.67	$ 713,826
Options exercisable— September 30, 2013		10,666	$ 2.10	7.90	$ 420,595

The following table summarizes the assumptions used in the Black-Scholes option-pricing model to determine fair value of our stock options:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Fair value of common stock	$12.90 - $20.00	$3.66	$6.05 - $20.00	$2.00 - $3.66
Risk-free interest rate	1.6% - 2.1%	0.9%	0.6% - 2.1%	0.8% - 1.4%
Expected term (in years)	5 - 6	6	4 - 6	5 - 6
Volatility	49% - 54%	51% - 52%	49% - 54%	44% - 52%
Dividend yield	—%	—%	—%	—%

The total grant date fair value of stock options vested during the three and nine months ended September 30, 2013 was $1.6 million and $3.6 million. The total grant date fair value of stock options vested during the three and nine months ended September 30, 2012 was $0.4 million and $0.9 million. The aggregate intrinsic value of all stock options exercised during the three and nine months ended September 30, 2013 was $7.0 million and $40.6 million. The aggregate intrinsic value of all stock options exercised during the three and nine months ended September 30, 2012 was $0.7 million and $1.8 million.

Restricted Stock Awards and Restricted Stock Units

A summary of information related to restricted stock awards and restricted stock units are presented below (in thousands, except per share):

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	Number of Shares	Weighted-Average Grant-Date Fair Value Per Share	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Unvested balance—December 31, 2012	1,895	$2.29	1.15	$5,971
Granted	659	8.07		
Vested	(527)	5.50		
Canceled/forfeited	(60)	6.20		
Unvested balance —September 30, 2013 (unaudited)	1,967	$3.25	0.77	$75,334
RSUs vested and expected to vest—September 30, 2013	1,869	$3.25	0.77	$71,567

Employee Stock Purchase Plans Expense and Assumptions used in Valuation

During the three months ended September 30, 2013, compensation expense recognized in connection with the Purchase Plan was $0.2 million. The following table summarizes the assumptions related to the Purchase Plan:

	Three Months Ended September 30,	
	2013	2012
Fair value of common stock	$20.00	NA
Risk-free interest rate	0.1%	NA
Expected term (in years)	0.7 - 1.2	NA
Volatility	42% - 45%	NA
Dividend yield	—%	NA

Stock-Based Compensation

Stock-based compensation expense is included in costs and expenses as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Cost of product revenue	$143	$27	$279	$60
Cost of subscription and services revenue	762	18	1,330	39
Research and development	2,350	433	4,425	671
Sales and marketing	3,784	341	5,878	902
General and administrative	1,775	1,289	4,432	2,249
Total	$8,814	$2,108	$16,344	$3,921

As of September 30, 2013 and 2012, total compensation cost related to unvested stock-based awards granted to employees under our stock option plans and Purchase Plan but not yet recognized was $69.2 million and $14.7 million, net of estimated forfeitures, respectively. This cost for all periods is expected to be amortized on a straight-line basis over the weighted-average remaining vesting period of approximately three years. Future grants will increase the amount of compensation expense to be recorded in future periods.

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12. Income Taxes

We account for income taxes under the asset and liability method. Under this method, deferred income tax assets and liabilities are determined based upon the difference between the financial statement carrying amounts and the tax basis of assets and liabilities and are measured using the enacted tax rate expected to apply to taxable income in the years in which the differences are expected to be reversed.

Our benefit for income taxes for the three and nine month periods ended September 30, 2013 reflects an effective tax rate of 1.77% and 0.27%, respectively. The benefit is primarily due to a reduction of the U.S. valuation allowance resulting from recording a deferred tax liability on the acquisition-related intangibles for which no benefit will be derived partially offset by foreign and state income tax expense.

Our provision for income taxes for the three and nine month periods ended September 30, 2012 reflects an effective rate of 0.61% and 0.49%, respectively. The tax expense is primarily due to foreign and state income tax expense.

13. Net Loss per Share

Basic loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period, less shares subject to repurchase, and excludes any dilutive effects of employee share based awards and warrants. Diluted net income per common share is computed giving effect to all potential dilutive common shares, including common stock issuable upon exercise of stock options, and unvested restricted common stock and stock units. As we had net losses for the three and nine months ended September 30, 2013 and 2012, all potential common shares were determined to be anti-dilutive.

The following table sets forth the computation of net loss per common share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net loss	$(50,926)	$(8,852)	$(118,122)	$(23,180)
Denominator:				
Weighted average number of shares outstanding—basic and diluted	31,590	11,025	21,838	9,955
Net loss per share—basic and diluted	$(1.61)	$(0.80)	$(5.41)	$(2.33)

The following outstanding options, unvested shares, warrants, and convertible preferred stock were excluded (as common stock equivalents) from the computation of diluted net loss per common share for the periods presented as their effect would have been antidilutive (in thousands):

	As of September 30,	
	2013	2012
Options to purchase common stock	22,707	18,161
Unvested early exercised common shares	5,240	8,554
Unvested restricted stock awards and units	2,140	—
Convertible preferred stock	—	69,473
Warrants to purchase convertible preferred stock	—	616
Warrants to purchase common stock	616	—

14. Employee Benefit Plan

401(k) Plan

We have established a 401(k) tax-deferred savings plan (the “401(k) PlanR