A10 Networks, Inc.
Form 10-Q
November 06, 2015

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, 2015
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: 001-36343

A10 NETWORKS, INC.
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| Delaware | 20-1446869 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| 3 West Plumeria Drive San Jose, California | 95134 |
| (Address of Principal Executive Offices) | (Zip Code) |

(408) 325-8668
(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 x 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 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

As of October 30, 2015 the number of outstanding shares of the registrant's common stock, par value $0.00001 per share, was 63,335,758.

A10 Networks, Inc.
Quarterly Report on Form 10-Q
For the Three And Nine Months Ended September 30, 2015

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A10 NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands, except par value)

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $100,524 | $91,905 |
| Accounts receivable, net of allowances of $3,227 and $3,246 as of September 30, 2015 and December 31, 2014 | 41,492 | 54,003 |
| Inventory | 17,566 | 20,701 |
| Prepaid expenses and other current assets | 4,918 | 4,732 |
| Total current assets | 164,500 | 171,341 |
| Property and equipment, net | 9,087 | 10,780 |
| Other long-term assets | 4,372 | 4,859 |
| Total Assets | $177,959 | $186,980 |
| LIABILITIES AND STOCKHOLDERS’ EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | $8,182 | $8,994 |
| Accrued liabilities | 20,960 | 22,435 |
| Deferred revenue, current | 44,352 | 39,256 |
| Total current liabilities | 73,494 | 70,685 |
| Deferred revenue, non-current | 21,986 | 17,964 |
| Other non-current liabilities | 1,541 | 1,766 |
| Total Liabilities | 97,021 | 90,415 |
| Commitments and contingencies (Note 5) | | |
| Stockholders' Equity: | | |
| Common stock, par value $0.00001 — 500,000 shares authorized as of September 30, 2015 and December 31, 2014; 63,244 and 61,377 shares issued and outstanding as of September 30, 2015 and December 31, 2014 | 1 | 1 |
| Additional paid-in capital | 295,400 | 278,349 |
| Accumulated deficit | (214,463) | (181,785) |
| Total Stockholders' Equity | 80,938 | 96,565 |
| Total Liabilities And Stockholders' Equity | $177,959 | $186,980 |

See accompanying notes to the condensed consolidated financial statements.

A10 NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue: | | | | |
| Products | $34,990 | $31,601 | $98,837 | $102,140 |
| Services | 15,788 | 11,827 | 43,494 | 32,165 |
| Total revenue | 50,778 | 43,428 | 142,331 | 134,305 |
| Cost of revenue: | | | | |
| Products | 8,529 | 8,818 | 23,501 | 23,655 |
| Services | 4,186 | 2,935 | 11,601 | 8,491 |
| Total cost of revenue | 12,715 | 11,753 | 35,102 | 32,146 |
| Gross profit | 38,063 | 31,675 | 107,229 | 102,159 |
| Operating expenses: | | | | |
| Sales and marketing | 25,774 | 24,651 | 75,258 | 70,189 |
| Research and development | 13,562 | 12,342 | 41,542 | 35,416 |
| General and administrative | 6,892 | 5,141 | 20,122 | 16,035 |
| Litigation expense (benefit) | 469 | 910 | 1,939 | (3,103) |
| Total operating expenses | 46,697 | 43,044 | 138,861 | 118,537 |
| Loss from operations | (8,634) | (11,369) | (31,632) | (16,378) |
| Other income (expense), net: | | | | |
| Interest expense | (151) | (192) | (382) | (904) |
| Interest income and other income (expense), net | 22 | (510) | (167) | (673) |
| Total other income (expense), net | (129) | (702) | (549) | (1,577) |
| Loss before provision for income taxes | (8,763) | (12,071) | (32,181) | (17,955) |
| Provision for income taxes | 204 | 233 | 497 | 747 |
| Net loss | (8,967) | (12,304) | (32,678) | (18,702) |
| Accretion of redeemable convertible preferred stock dividend | — | — | — | (1,150) |
| Net loss attributable to common stockholders | $(8,967) | $(12,304) | $(32,678) | $(19,852) |
| Net loss per share attributable to common stockholders: | | | | |
| Basic and Diluted | $(0.14) | $(0.21) | $(0.53) | $(0.45) |
| Weighted-average shares used in computing net loss per share attributable to common stockholders: | | | | |
| Basic and Diluted | 62,753 | 59,913 | 62,009 | 44,538 |

See accompanying notes to the condensed consolidated financial statements.

A10 NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2015 | 2014 |
| Cash flows from operating activities: | | |
| Net loss | $(32,678) | (18,702) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 6,784 | 7,337 |
| Stock-based compensation | 13,246 | 8,314 |
| Gain on settlement of contractual liability | — | (6,993) |
| Provision for doubtful accounts and sales allowance | 1,575 | 52 |
| Other non cash items | 14 | (31) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 11,223 | (4,771) |
| Inventory | 922 | (6,276) |
| Prepaid expenses and other assets | (97) | (3,303) |
| Accounts payable | (1,086) | 4,109 |
| Accrued liabilities | (1,510) | 4,102 |
| Accrued litigation expenses | 18 | (6,832) |
| Deferred revenue | 9,118 | 9,670 |
| Other | 104 | (197) |
| Net cash provided by (used in) operating activities | 7,633 | (13,521) |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (2,558) | (5,380) |
| Net cash used in investing activities | (2,558) | (5,380) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock under employee equity incentive plans, net of repurchases | 3,238 | 4,399 |
| Proceeds from initial public offering, net of offering costs | — | 121,037 |
| Principal payments on revolving credit facility | — | (20,000) |
| Other | 306 | (229) |
| Net cash provided by financing activities | 3,544 | 105,207 |
| Net increase in cash and cash equivalents | 8,619 | 86,306 |
| Cash and cash equivalents—beginning of period | 91,905 | 20,793 |
| Cash and cash equivalents—end of period | $100,524 | $107,099 |
| Supplemental Disclosure of Non-Cash Investing and Financing Activities: | | |
| Inventory transfers to property and equipment | $2,213 | $4,072 |
| Vesting of early exercised stock options | $366 | $556 |
| Accretion of Series D redeemable convertible preferred stock | $— | $1,150 |

See accompanying notes to the condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Description of Business and Summary of Significant Accounting Policies
Description of Business

A10 Networks, Inc. (together with our subsidiaries, the “Company”, “we”, “our” or “us”) was incorporated in California in 2004 and reincorporated in Delaware in March 2014. We are headquartered in San Jose, California and have wholly-owned subsidiaries throughout the world including Asia and Europe. Our solutions enable enterprises, service providers, Web giants and government organizations to accelerate, secure and optimize the performance of their data center applications and networks. We currently offer three software based advanced application networking solutions. These are Application Delivery Controllers, or ADCs, to optimize data center performance; Carrier Grade Network Address Translation, or CGN, to provide address and protocol translation services for service provider networks; and a Distributed Denial of Service Threat Protection System, or TPS, for network-wide security protection. We deliver these solutions both on optimized hardware appliances and as virtual appliances across our Thunder Series and AX Series product families.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of A10 Networks, Inc., and our wholly owned subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

We had no comprehensive income (loss) other than our net income (loss), hence our comprehensive income (loss) is the same as the net income (loss) for all periods presented. Pursuant to the accounting guidance provided by Accounting Standard Codification ("ASC") 220 Comprehensive Income, we did not present statements of comprehensive income (loss) for the periods presented.

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 notes 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 presentation of our financial information. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015 or for any other interim period or for any other future year. The balance sheet as of December 31, 2014 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 unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2014, which are included in the Annual Report on Form 10-K filed with the SEC on March 11, 2015.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements

and accompanying notes. Those estimates and assumptions affect revenue recognition and deferred revenue, allowance for doubtful accounts, sales return reserve, valuation of inventory, contingencies and litigation, and determination of fair value of stock-based compensation. These estimates are based on information available as of the date of the condensed consolidated financial statements; therefore, actual results could differ from management's estimates.

Summary of Significant Accounting Policies

There have been no changes to the significant accounting policies described in the 2014 Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes.

Concentration of Credit Risk and Significant Customers

Financial instruments that potentially subject us to concentrations of credit risk consist of cash, cash equivalents and accounts receivable. Our cash and cash equivalents are invested in high-credit quality financial instruments with banks and financial institutions. Management believes that the financial institutions that hold our cash and cash equivalents are financially sound and, accordingly, are subject to minimal credit risk. Such deposits may be in excess of insured limits provided on such deposits.

Our accounts receivable are unsecured and represent amounts due to us based on contractual obligations of our customers. We mitigate credit risk in respect to accounts receivable by performing periodic credit evaluations of our customers to assess the probability of accounts receivable collection based on a number of factors, including past transaction experience with the customer, evaluation of their credit history, limiting the credit extended and review of the invoicing terms of the contract. We generally do not require our customers to provide collateral to support accounts receivable.

Significant customers, including distribution channel partners and direct customers, are those which represent more than 10% of our total revenue for each period presented or our gross accounts receivable balance as of each respective balance sheet date. Revenue from our significant customers as a percentage of our total revenue for the three and nine months ended September 30, 2015 and 2014 are as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| Customers | 2015 | 2014 | 2015 | 2014 |
| Customer A | * | 13% | * | 14% |

* represents less than 10% of total revenue

As of September 30, 2015 and December 31, 2014, no customer accounted for 10% or more of our total gross accounts receivable.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which provides new guidance on the recognition of revenue and states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. The original effective date of this accounting standard was annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of the new revenue standard for periods beginning after December 15, 2016 to December 15, 2017, with early adoption permitted but not earlier than the original effective date. This updated standard is effective for us on January 1, 2018. We are currently evaluating the impact of the adoption of this accounting standard update on our consolidated financial position or results of operations and method of adoption.

In April 2015, the FASB issued 2015-03 Interest—Imputation of Interest (Subtopic 835-30) Simplifying the Presentation of Debt Issuance Costs and during August 2015, the FASB issued ASU No. 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, which clarifies the treatment of debt issuance costs from line-of-credit arrangements after adoption of ASU No. 2015-03. This accounting guidance

requires debt issuance costs be presented on the balance sheet as a direct reduction from the carrying amount of the related debt liability. ASU No. 2015-15 clarifies that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU No. 2015-03 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. We believe the adoption of ASU No. 2015-15 will not have a material effect on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. Under this accounting guidance, inventory will be measured at the lower of cost and net realizable value and other options that currently exist for market value will be eliminated. ASU No. 2015-11 defines net realizable value as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. No other changes were made to the current guidance on inventory measurement. This accounting guidance is effective for us in the first quarter of 2017. Early adoption is permitted. We are currently evaluating the impact of the adoption of this accounting standard update on our consolidated financial statements.

There have been no other recent accounting pronouncements or changes in accounting pronouncements during the nine months ended September 30, 2015, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2014 filed with SEC on March 11, 2015, that are of significance or potential significance to us.

2. Fair Value Measurements

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. Cash equivalents, which include money market funds, are stated at amortized cost, which approximates fair value as of the balance sheet dates, due to the short period of time to maturity. Accounts receivable, accounts payable and accrued liabilities are stated at their carrying value, which approximates fair value due to the short time to the expected receipt or payment.

Cash and cash equivalents are carried at fair value. Our money market funds are classified within Level I of the fair value hierarchy, as these instruments are valued using quoted market prices. Specifically, we value our investments in money market securities based on quoted market prices in active markets. As of September 30, 2015 and December 31, 2014, we had no assets or liabilities classified within Level II or Level III and there were no transfers of instruments between Level I, Level II and Level III regarding fair value measurement.

The following table sets forth the fair value of our financial assets measured on a recurring basis, by level, within the fair value hierarchy (in thousands):

| | September 30, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| | Level I | Total | Level I | Total |
| Financial Assets | | | | |
| Money market funds | $41,070 | $41,070 | $51,047 | $51,047 |

We did not have realized gains or losses for the three and nine months ended September 30, 2015 and 2014 related to our financial assets.

3. Balance Sheets and Statements of Operations Components

Inventory

Components of inventory as of September 30, 2015 and December 31, 2014 are shown below (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Raw materials | $8,731 | $9,922 |
| Finished goods | 8,835 | 10,779 |
| Total inventory | $17,566 | $20,701 |

Property and Equipment, Net

Components of property and equipment, net as of September 30, 2015 and December 31, 2014 are shown below (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Equipment | $34,512 | $30,486 |
| Software | 3,518 | 3,197 |
| Furniture and fixtures | 862 | 860 |
| Leasehold improvements | 2,295 | 1,780 |
| Construction in progress | 163 | 201 |
| Property and equipment, gross | 41,350 | 36,524 |
| Less: accumulated depreciation and amortization | (32,263) | (25,744) |
| Total property and equipment, net | $9,087 | $10,780 |

Depreciation and amortization on our property and equipment for the three months ended September 30, 2015 and 2014 was $2.1 million and $2.6 million. Depreciation and amortization on our property and equipment for the nine months ended September 30, 2015 and 2014 was $6.7 million and $7.2 million.

Deferred Revenue

Deferred revenue as of September 30, 2015 and December 31, 2014 consists of the following (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Deferred revenue: | | |
| Products | $3,169 | $2,379 |
| Services | 63,169 | 54,841 |
| Total deferred revenue | 66,338 | 57,220 |
| Less: current portion | (44,352) | (39,256) |
| Non-current portion | $21,986 | $17,964 |

Accrued Liabilities

Accrued liabilities as of September 30, 2015 and December 31, 2014 consists of the following (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Accrued compensation and benefits | $14,459 | $14,447 |
| Accrued tax liabilities | 2,753 | 2,554 |
| Other | 3,748 | 5,434 |
| Total accrued liabilities | $20,960 | $22,435 |

4. Credit Facility

In September 2013, we entered into a credit agreement with Royal Bank of Canada, JPMorgan Chase Bank, N.A. and Bank of America, N.A. as lenders. The credit agreement provides a three-year, $35.0 million, revolving credit facility, which includes a maximum $10.0 million letter of credit facility. As of September 30, 2015 and December 31, 2014, we have no outstanding borrowings under this credit facility.

Our obligations under the credit agreement are secured by a security interest on substantially all of our assets, including our intellectual property. The credit agreement contains customary financial and non-financial covenants, and are described in Note 4, Credit Facility of the Notes to Consolidated Financial Statements of our Annual Report on Form 10-K for

the year ended December 31, 2014 filed with the SEC on March 11, 2015. We were in compliance with all financial and nonfinancial covenants under the revolving credit facility as of September 30, 2015.
At our option, the revolving credit facility bears interest at a rate per annum based on either (i) an alternate base rate plus a margin ranging from 1.75% to 2.50% depending on our total leverage ratio, or (ii) the London interbank offered rate, or LIBOR, based on one, two, three or six month interest periods plus a margin ranging from 2.75% to 3.50% depending on our total leverage ratio. The alternate base rate is equal to the greatest of (i) the Royal Bank of Canada’s prime rate, (ii) the federal funds rate plus a margin equal to 0.50% and (iii) the Eurodollar rate for a one month interest period plus a margin equal to 1.00%.
In addition, we incurred $1.0 million of debt issuance costs that were directly attributable to the issuance of this revolving credit facility which will be amortized to interest expense over the three-year term of this credit facility. As of September 30, 2015, the unamortized debt issuance costs of $0.3 million were included within other long-term assets in our Condensed Consolidated Balance Sheets. We are also required to pay quarterly facility fees of 0.45% per annum on the average daily unused portion of the revolving credit facility.

5. Commitments and Contingencies

Legal Proceedings

From time to time, we may be party or subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business, including proceedings and claims that relate to intellectual property matters. Some of these proceedings involve claims that are subject to substantial uncertainties and unascertainable damages. Accordingly, except as disclosed, we have not established reserves or ranges of possible loss related to these proceedings, as at this time in the proceedings, if any, the matters do not relate to a probable loss and/or amounts cannot be reasonably estimated.

In November 2013, Parallel Networks, LLC (“Parallel Networks”), which we believe is a non-practicing patent holding company, filed a lawsuit against us in the United States District Court for the District of Delaware, alleging that our AX and Thunder series products infringe two of their U.S. patents. In June 2015, we entered into a settlement agreement whereby we obtained a fully-paid up license and the case was dismissed.

On January 29, 2015, the Company, the members of our Board of Directors, our Chief Financial Officer, and the underwriters of our March 21, 2014 Initial Public Offering ("IPO") were named as defendants in a putative class action lawsuit filed in the Superior Court of the State of California, County of Santa Clara, captioned City of Warren Police and Fire Retirement System v. A10 Networks, Inc., et al., 1-15-CV-276207. Several substantially identical lawsuits were subsequently filed in the same court, bringing the same claims against the same defendants, captioned Arkansas Teacher Retirement System v. A10 Networks, Inc., et al., 1-15-CV-278575 (filed March 25, 2015) and Kaveny v. A10 Networks, Inc., et al., 1-15-CV-279006 (filed April 6, 2015). On May 29, 2015, the aforementioned putative class actions were consolidated under the caption In re A10 Networks, Inc. Shareholder Litigation, 1-15-CV-276207. On June 30, 2015, plaintiffs filed a Consolidated Class Action Complaint. The Consolidated Complaint seeks to allege violations of the federal Securities Act of 1933 on behalf of a putative class consisting of purchasers of our common stock pursuant or traceable to the registration statement and prospectus for the initial public offering, and seek unspecified compensatory damages and other relief. On July 31, 2015, the defendants filed demurrers, which the plaintiffs opposed, and which are currently set for a hearing before the Superior Court on November 6, 2015. We intend to vigorously defend these lawsuits.

On June 24, 2015, our directors and certain of our officers were named as defendants in a putative derivative lawsuit filed in the Superior Court of the State of California, County of Santa Clara, captioned Hornung v. Chen, et al., 1-15-CV-282286. We were also named as a nominal defendant. The complaint seeks to allege breaches of fiduciary duties and other related claims, arising out of allegations that our officers and directors caused us to infringe patents and intellectual property, improperly approved the settlement of prior litigation, failed to adopt and implement

effective internal controls, and caused us to issue false and misleading statements in connection with our IPO. Plaintiff seeks unspecified compensatory damages and other equitable relief. We intend to vigorously defend these lawsuits.

Lease Obligations and Other Commitments

Commencing in 2012, we entered into an equipment financing arrangement with a financial institution whereby the financial institution purchases and leases to us, equipment (primarily computer and network-related) for use in our business. Amounts financed under the leases are accounted for as capital leases. We financed $0.8 million under the arrangement in 2012, which was fully repaid by December 2014. In March 2015, we entered into an agreement to lease an additional $0.3

million of equipment under this financing arrangement. The various leased equipment was delivered to us by the end of the third quarter of 2015. As of September 30, 2015, we had $0.3 million in outstanding capital lease obligations. We had no outstanding borrowings under this financing arrangement as of December 31, 2014.

We lease various operating spaces in the United States, Asia, and Europe under non-cancelable operating lease arrangements that expire on various dates through February 2020. These arrangements require us to pay certain operating expenses, such as taxes, repairs, and insurance and contain renewal and escalation clauses. We recognize rent expense under these arrangements on a straight-line basis over the term of the lease.

We have entered into agreements with some of our customers and channel partners that contain indemnification provisions in the event of claims alleging that our products infringe the intellectual property rights of a third party. Other guarantees or indemnification arrangements include guarantees of product and service performance and standby letters of credit for lease facilities and corporate credit cards. We have not recorded a liability related to these indemnification and guarantee provisions and our guarantees and indemnification arrangements have not had any significant impact on our consolidated financial statements to date.

6. Equity Award Plans

Equity Incentive Plans

2014 Equity Incentive Plan

Our 2014 Equity Incentive Plan (the "2014 Plan") was adopted by our Board of Directors and approved by our stockholders in March 2014. The 2014 Plan provides for the granting of stock options, restricted stock awards, restricted stock units, stock appreciation rights, performance units and performance shares to our employees, directors and consultants.

As of December 31, 2014, we had 1,343,743 shares available for future grant. Annually, the shares authorized for the Plan will increase by the least of (i) 8,000,000 shares, (ii) 5% of the outstanding shares of common stock on the last day of our immediately preceding fiscal year, or (iii) such other amount as determined by our Board of Directors. On January 1, 2015, the number of shares in the 2014 Plan was increased by 3,078,645 shares, which represents 5% of the prior year end’s common stock outstanding. In addition, effective as of June 10, 2015, our Board of Directors adopted, and our stockholders approved, an amendment and restatement of our 2014 Plan, which increased the number of shares available for issuance under the 2014 Plan by the number of shares available from the 2008 Plan that were canceled or otherwise forfeited or repurchased by us after March 20, 2014. A maximum of 8,310,566 shares may become available from the 2008 Plan for issuance under the 2014 Plan. As of September 30, 2015, 1,374,975 shares of our common stock were eligible to be added to the 2014 Plan share reserve in accordance with the amendment and restatement of the 2014 Plan. During the nine months ended September 30, 2015, we granted 408,500 stock options and 1,295,806 restricted stock units ("RSUs") under the 2014 Plan to our employees, directors and consultants. As of September 30, 2015, we have 3,532,415 shares available for future grant, excluding shares eligible to be added from the 2008 Plan.

2014 Employee Stock Purchase Plan

The 2014 Employee Stock Purchase Plan (the "2014 Purchase Plan") was adopted by our Board of Directors and approved by our stockholders in March 2014.

As of December 31, 2014, we had 1,031,316 shares available for future purchase. Under the provisions of the 2014 Purchase Plan, on the first day of each fiscal year, starting with January 1, 2015, the number of shares in the reserve will increase by the lesser of (i) 3,500,000 shares, (ii) 1% of the outstanding shares of our common stock on the last

day of the immediately preceding fiscal year, or (iii) such other amount as determined by our Board of Directors or other committee administering the 2014 Purchase Plan. In January 2015, we increased common shares reserved for future purchase by 615,729 shares in accordance with the provision of the 2014 Purchase Plan. The participants of the plan purchased 542,102 shares during the nine months ended September 30, 2015, and as of September 30, 2015, we have 1,104,943 shares available for future purchase.

Stock-based Compensation

Stock-based compensation is based on the estimated fair value of awards, net of estimated forfeitures, and recognized over the requisite service period. The following is a summary of stock-based compensation for stock-based awards granted under the 2014 Plan, the 2008 Plan, and employee stock purchases under the 2014 Purchase Plan recognized during the three and nine months ended September 30, 2015 and 2014 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Stock-based compensation by type of award: | | | | |
| Stock options | $1,347 | $1,615 | $4,326 | $5,012 |
| Restricted stock units | 2,412 | 929 | 6,477 | 965 |
| Employee stock purchase plan | 849 | 994 | 2,443 | 2,337 |
| Total stock-based compensation | $4,608 | $3,538 | $13,246 | $8,314 |
| | | | | |
| Stock-based compensation by category of expense: | | | | |
| Cost of revenue | $428 | $277 | $1,241 | $578 |
| Sales and marketing | 2,093 | 1,700 | 6,032 | 4,041 |
| Research and development | 1,489 | 1,139 | 4,347 | 2,546 |
| General and administrative | 598 | 422 | 1,626 | 1,149 |
| | $4,608 | $3,538 | $13,246 | $8,314 |

At September 30, 2015, we had $26.6 million of unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options, unvested restricted stock units and 2014 Purchase Plan purchases. This unamortized stock-based compensation expense will be recognized over a weighted-average period of 2.6 years.

Determination of Fair Value

We use the Black-Scholes option pricing model to determine the grant date fair value of stock options and stock purchases and generally recognize stock-based compensation expense on a straight-line basis over the requisite service period.

The determination of the fair value on the date of grant is affected by the estimated underlying common stock price, as well as assumptions regarding a number of complex and subjective variables. These variables include expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rates, and expected dividends.

The fair value of the stock options and employee stock purchases were determined using the Black-Scholes option pricing model and assumptions discussed below. Each of these inputs is subjective and generally requires significant judgment to determine.

• Expected Term. We estimate the expected life of options based on an analysis of our historical experience of employee exercise and post-vesting termination behavior considered in relation to the contractual life of the option. The expected term for the 2014 Purchase Plan is based on the term of the purchase period.

• Risk-Free Interest Rate. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for zero coupon U.S. Treasury notes with maturities approximately equal to the expected terms of stock options and shares to be issued under the 2014 Purchase Plan.

• Expected Volatility. Due to the limited trading history of our own common stock, we determined the share price volatility factor based on a combination of the historical volatility of our own common stock and the historical volatility of our peer group.

• Dividend Rate. The expected dividend was assumed to be zero as we have never paid dividends and have no current plans to do so.



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We estimate the fair value of RSUs using the closing market price of our common stock on the grant date.

Stock Option Activity

The following table summarizes our stock option activity and related information as of and for the nine months ended September 30, 2015 (in thousands, except for years and per share amounts):

| | Number of Shares Underlying Outstanding Options | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding as of December 31, 2014 | 11,084 | $ 5.18 | 7.9 | |
| Granted | 408 | $ 4.84 | | |
| Exercised | (535 ) | $ 2.93 | | |
| Canceled (1) | (922 ) | $ 7.27 | | |
| Outstanding as of September 30, 2015 | 10,035 | $ 5.10 | 7.4 | $17,394 |
| Vested and expected to vest as of September 30, 2015 | 9,633 | $ 5.06 | 7.3 | $16,950 |
| Vested and exercisable as of September 30, 2015 | 5,592 | $ 4.27 | 6.3 | $13,179 |

(1) Common shares granted under the 2008 Plan and canceled after March 20, 2014 are reallocated to the 2014 Plan's share reserve as they become available for issuance under the 2014 Plan. During the nine months ended September 30, 2015, 469,440 shares of the canceled stock options were eligible to be reallocated to the 2014 Plan share reserve.

As of September 30, 2015, the aggregate intrinsic value represents the excess of the closing price of our common stock of $5.99 over the exercise price of the outstanding in-the-money options.

The following table provides information pertaining to our stock options for the nine months ended September 30, 2015 and 2014 (in thousands, except weighted-average fair values):

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2015 | 2014 |
| Total fair value of options granted | $869 | $7,536 |
| Weighted average fair value of options granted | $2.13 | $5.96 |
| Intrinsic value of options exercised | $1,535 | $13,900 |

The estimated grant-date fair value of our stock options issued to employees was calculated using the Black-Scholes option-pricing model, based on the following assumptions:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Expected term (in years) | n/a | n/a | 4.80 | 5.5 |
| Risk-free interest rate | n/a | n/a | 1.60% | 1.73% |
| Expected volatility | n/a | n/a | 50% | 47% |
| Dividend rate | n/a | n/a | —% | —% |

We did not grant any stock options during each of the three months ended September 30, 2015, and 2014.

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Restricted Stock Units Activity

We have granted time-based RSUs to our employees, directors and consultants and market performance-based restricted stock units ("MSUs") to certain company executives.

Time-based Restricted Stock Units

A summary of RSUs activities for the nine months ended September 30, 2015, is as follows (in thousands, except years and per share amounts):

| | Number of Shares | Weighted Average Grant Date Fair Value | Weighted Average Remaining Service Period (in years) | Aggregated Intrinsic Value |
|---|---|---|---|---|
| Outstanding as of December 31, 2014 | 2,388 | $8.97 | | |
| Granted | 1,256 | $5.48 | | |
| Released | (713) | $10.82 | | |
| Canceled | (359) | $9.19 | | |
| Outstanding as of September 30, 2015 | 2,572 | $6.72 | 1.7 | $15,409 |

The aggregate intrinsic value is the amount that would have been received by the unit holders had all RSUs been vested and released on September 30, 2015. This amount will fluctuate based on the fair market value of our stock.

Market Performance-based Restricted Stock Units

We granted MSUs covering 540,000 shares and 40,000 shares of our common stock to certain company executives during 2014 and the nine months ended September 30, 2015, all of which were outstanding as of September 30, 2015. These MSUs will vest if the closing price of our common stock remains above certain predetermined target prices for 20 consecutive trading days within a 4-year period following the award's grant date, subject to continued service by the award holder.

The total aggregate intrinsic value for the MSUs granted was $3.5 million, which represents the total pre-tax intrinsic value (calculated by multiplying our closing stock price on the last trading day of the period by the number of unvested MSUs) that would have been received by the award holders had all MSUs vested and been released on September 30, 2015. This amount will fluctuate based on the fair market value of our stock. No MSUs were vested or released during the nine months ended September 30, 2015.

Employee Stock Purchase Plan

The fair value of the option component of the 2014 Purchase Plan shares was determined at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

| | Three and Nine Months Ended September 30, | |
|---|---|---|
| | 2015 | 2014 |
| Expected term (in years) | 1.2 | 1.4 |
| Risk-free interest rate | 0.32% | 0.24% |

| | | |
|---|---|---|
| Expected volatility | 40% | 31% |
| Dividend rate | —% | —% |

7. Net Income Per Share Available (Loss Attributable) To Common Stockholders

The following table sets forth the computation of our basic and diluted net loss per share attributable to common stockholders (in thousands, except per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Basic and diluted net loss per share attributable to common stockholders | | | | |
| Numerator: | | | | |
| Net loss attributable to common stockholders | $(8,967) | $(12,304) | $(32,678) | $(19,852) |
| Denominator: | | | | |
| Weighted-average shares outstanding - basic | 62,753 | 59,913 | 62,009 | 44,538 |
| Effect of dilutive potential common shares from stock options, restricted stock units and employee stock purchase plan | — | — | — | — |
| Weighted-average shares outstanding - diluted | 62,753 | 59,913 | 62,009 | 44,538 |
| Net loss per share attributable to common stockholders: | | | | |
| Basic and diluted | $(0.14) | $(0.21) | $(0.53) | $(0.45) |

The following weighted average outstanding shares of common stock equivalents were excluded from the computation of diluted net loss per share attributable to common stockholders for the periods presented because including them would have been antidilutive (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Stock options, restricted stock units and employee stock purchase plan | 15,511 | 10,435 | 14,501 | 10,241 |
| Common stock subject to repurchase | 70 | 244 | 70 | 244 |
| | 15,581 | 10,679 | 14,571 | 10,485 |

8. Income Taxes

We recorded income tax expense of $0.2 million and $0.5 million for the three and nine months ended September 30, 2015, which was primarily comprised of state and foreign taxes. We recorded income tax expense of $0.2 million and $0.7 million for the three and nine months ended September 30, 2014, which was primarily comprised of state and foreign taxes. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities in the financial statements and their respective tax bases using tax rates expected to be in effect during the years in which the basis differences reverse.

We believe it is more likely than not that our federal and state net deferred tax assets will not be fully realized. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of a deferred tax asset will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. A valuation allowance is recorded for loss carryforwards and other deferred tax assets where it is more likely than not that such deferred tax assets will not be realized. Accordingly, we continue to maintain a valuation allowance against

all of our net deferred tax assets as of September 30, 2015. Due to past losses in the U.S., we have a full valuation allowance on the U.S. federal and state deferred tax assets. We will continue to maintain a full valuation allowance against our net federal, state and certain foreign deferred tax assets until there is sufficient evidence to support recoverability of our deferred tax assets.

We had $2.4 million and $2.2 million of unrecognized tax benefits as of September 30, 2015 and December 31, 2014. We do not anticipate a material change to our unrecognized tax benefits over the next twelve months. Unrecognized tax benefits may change during the next twelve months for items that arise in the ordinary course of business.

9. Segment Information

Our chief operating decision maker is our Chief Executive Officer who reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenue by geographic region for purposes of allocating resources and evaluating financial performance. Accordingly, we have a single reportable segment and operating segment structure.

The following table represents revenue by geographic areas based on customers' location, as determined by their ship to addresses (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| United States | $25,059 | $20,445 | $75,365 | $64,873 |
| Japan | 8,764 | 9,893 | 24,222 | 35,668 |
| Asia Pacific, excluding Japan | 7,991 | 6,285 | 18,122 | 14,960 |
| EMEA | 7,317 | 4,940 | 20,372 | 13,005 |
| Other | 1,647 | 1,865 | 4,250 | 5,799 |
| Total revenue | $50,778 | $43,428 | $142,331 | $134,305 |

No other country outside of the United States and Japan comprised 10% or greater of our revenue for the three and nine months ended September 30, 2015 and 2014.

Geographical information relating to our long-lived assets which include property and equipment, net and intangible assets, net as of September 30, 2015 and December 31, 2014 was as follows (in thousands):

| | September 30, 2015 | December 31, 2014 |
|---|---|---|
| United States | $8,274 | $9,702 |
| Asia Pacific, excluding Japan | 1,499 | 1,724 |
| Other | 216 | 351 |
| Total property and equipment, net and intangible assets, net | $9,989 | $11,777 |

10. Related-Party Transactions

An affiliate of one of our significant stockholders is also acting as a reseller of our products. On May 27, 2015, the significant stockholder reduced its ownership of our common stock, and ceased to be a related party as its ownership percentage dropped to below 5%. During the nine months ended September 30, 2015, we recognized $2.2 million of revenue from this reseller while it was a related party. During the three and nine months ended September 30, 2014, we recognized $0.8 million and $2.0 million of total revenue from this reseller.

We had gross accounts receivable of $0.4 million from this reseller as of December 31, 2014.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words "believe," "may," "will," "potentially," "estimate," "continue," "anticipate," "intend," "could," "would," "project," "plan" "expect," and similar expressions that conve uncertainty of future events or outcomes are intended to identify forward-looking statements.

These forward-looking statements include, but are not limited to, statements concerning the following:

- our ability to maintain an adequate rate of revenue growth;
- our ability to successfully anticipate market needs and opportunities;
- our business plan and our ability to effectively manage our growth;
- costs associated with defending intellectual property infringement and other claims;
- our ability to attract and retain end-customers;
- loss or delay of expected purchases by our largest end-customers;
- our ability to further penetrate our existing customer base;
- our ability to displace existing products in established markets;
- our ability to expand our leadership position in next-generation application delivery and server load balancing solutions;
- continued growth in markets relating to network security;
- our ability to timely and effectively scale and adapt our existing technology;
- our ability to innovate new products and bring them to market in a timely manner;
- our ability to expand internationally;
- the effects of increased competition in our market and our ability to compete effectively;
- the effects of seasonal trends on our results of operations;
- our expectations concerning relationships with third parties;
- the attraction and retention of qualified employees and key personnel;
- our ability to achieve or maintain profitability while continuing to invest in our sales, marketing and research and development teams;
- variations in product mix or geographic locations of our sales;
- fluctuations in currency exchange rates;
- increased cost requirements of being a public company and future sales of substantial amounts of our common stock in the public markets;
- the cost and potential outcomes of existing and future litigation;
- our ability to maintain, protect, and enhance our brand and intellectual property; and
- future acquisitions of or investments in complementary companies, products, services or technologies.

These forward-looking statements are subject to a number of risks, uncertainties, and assumptions, including those described in "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking

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statements. We undertake no obligation to update publicly any forward-looking statements for any reason after the date of this Quarterly Report on Form 10-Q to conform these statements to actual results or to changes in our expectations, except as required by law.

Overview

We are a leading provider of application networking technologies. Our solutions enable service providers, enterprises, Web giants and government organizations to accelerate, secure and optimize the performance of their data center applications and networks. Our products are built on our Advanced Core Operating System ("ACOS") platform of advanced network technologies, which is designed to enable our products to deliver substantially greater performance and security relative to prior generation application networking products. Our software based ACOS architecture also provides the flexibility that enables us to expand our business to offer additional products to solve a growing array of networking and security challenges arising from increased Internet cloud and mobile computing.

We currently offer three software based advanced application networking solutions. These are Application Delivery Controllers ("ADCs") to optimize data center performance, Carrier Grade Network Address Translation ("CGN") to provide address and protocol translation services for service provider networks, and a Distributed Denial of Service Threat Protection System ("TPS") for network-wide security protection. We deliver these solutions both on optimized hardware appliances and as virtual appliances across our Thunder Series and AX Series product families.

We derive revenue from sales of products and related support services. Product revenue is generated primarily by sales of hardware appliances with perpetual licenses to our embedded software solutions. We generate services revenue primarily from sales of maintenance and support contracts. Our end customers predominantly purchase maintenance and support in conjunction with purchases of our products. In addition, we also derive revenues from the sale of professional services.

We sell our products globally to service providers and enterprises that depend on data center applications and networks to generate revenue and manage operations efficiently. Our end customers operate in a variety of industries, including telecommunications, technology, industrial, retail, financial, education and government. Since inception, our customer base has grown rapidly. As of September 30, 2015, we had sold products to approximately 4,500 customers across 73 countries.

We sell substantially all of our solutions through our high-touch sales organization as well as distribution channel partners, including distributors, value added resellers and system integrators, and fulfill nearly all orders globally through such partners. We believe this sales approach allows us to obtain the benefits of channel distribution, such as expanding our market coverage, while still maintaining face-to-face relationships with our end-customers. We outsource the manufacturing of our hardware products to original design manufacturers. We perform quality assurance and testing at our San Jose, Taiwan and Japan distribution centers, as well as at our manufacturers’ locations. We warehouse and deliver our products out of our San Jose warehouse for the Americas. We outsource warehousing and delivery to third-party logistics providers for delivery in other regions.

During the first nine months of 2015, 53% of our total revenue was generated from the United States, 17% from Japan, and 30% from other geographical regions. During the first nine months of 2014, 48% of our total revenue was generated from the United States, 27% from Japan and 25% from other geographical regions. Our enterprise customers accounted for 58% and 51% of our total revenue during the first nine months of 2015 and 2014. Our service provider customers accounted for 42% and 49% of our total revenue during the first nine months of 2015 and 2014.

As a result of the nature of our target market and the current stage of our development, a substantial portion of our revenue comes from a limited number of large end-customers, including service provers, in any period. During the first nine months of 2015 and 2014, purchases from our ten largest end-customers accounted for approximately 30%

and 41% of our total revenue. Sales to these large end-customers have typically been characterized by large but irregular purchases with long sales cycles. The timing of these purchases and the delivery of the purchased products is difficult to predict. As a consequence, any acceleration or delay in anticipated product purchases by, or deliveries to, our largest end customers could materially impact our revenue and operating results in any quarterly period. This may cause our quarterly revenue and operating results to fluctuate from quarter to quarter and make them difficult to predict.

We had $100.5 million of cash and cash equivalents as of September 30, 2015. Cash generated by operating activities was $7.6 million in the first nine months of 2015 compared to $13.5 million of cash used in operating activities in the same period of 2014.

We intend to continue to invest for long-term growth. We have invested in, and expect to continue to invest in, our product development efforts to deliver new products and additional features in our current products to address customer needs. In addition, we expect to continue to expand our global sales and marketing organizations, expand our distribution channel partner programs, and increase awareness of our solutions on a global basis. Additionally, we will be investing in general and administrative resources to meet the requirements to operate as a public company. Our investments in growth in these areas may affect short-term profitability.

Results of Operations

The following table provides a summary of our Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014 as derived from our condensed consolidated financial statements included in Part I Financial Information in this Quarterly Report on Form 10-Q (in thousands, except for percentages).

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Increase (Decrease) | |
| | Amount | Percent of Total Revenue | Amount | Percent of Total Revenue | Amount | Percent |
| Revenue: | | | | | | |
| Products | $34,990 | 68.9 % | $31,601 | 72.8 % | $3,389 | 10.7 % |
| Services | 15,788 | 31.1 | 11,827 | 27.2 | 3,961 | 33.5 |
| Total revenue | 50,778 | 100.0 | 43,428 | 100.0 | 7,350 | 16.9 |
| Cost of revenue: | | | | | | |
| Products | 8,529 | 16.8 | 8,818 | 20.3 | (289 ) | (3.3 ) |
| Services | 4,186 | 8.2 | 2,935 | 6.8 | 1,251 | 42.6 |
| Total cost of revenue | 12,715 | 25.0 | 11,753 | 27.1 | 962 | 8.2 |
| Gross profit | 38,063 | 75.0 | 31,675 | 72.9 | 6,388 | 20.2 |
| Operating expenses: | | | | | | |
| Sales and marketing | 25,774 | 50.8 | 24,651 | 56.8 | 1,123 | 4.6 |
| Research and development | 13,562 | 26.7 | 12,342 | 28.4 | 1,220 | 9.9 |
| General and administrative | 6,892 | 13.6 | 5,141 | 11.8 | 1,751 | 34.1 |
| Litigation expense | 469 | 0.9 | 910 | 2.1 | (441 ) | (48.5 ) |
| Total operating expenses | 46,697 | 92.0 | 43,044 | 99.1 | 3,653 | 8.5 |
| Loss from operations | (8,634 ) | (17.0 ) | (11,369 ) | (26.2 ) | 2,735 | (24.1 ) |
| Other income (expense), net: | | | | | | |
| Interest expense | (151 ) | (0.3 ) | (192 ) | (0.4 ) | 41 | (21.4 ) |
| Interest income and other income (expense), net | 22 | — | (510 ) | (1.2 ) | 532 | (104.3 ) |
| Total other income (expense), net | (129 ) | (0.3 ) | (702 ) | (1.6 ) | 573 | (81.6 ) |
| Loss before provision for income taxes | (8,763 ) | (17.3 ) | (12,071 ) | (27.8 ) | 3,308 | (27.4 ) |
| Provision for income taxes | 204 | 0.4 | 233 | 0.5 | (29 ) | (12.4 ) |
| Net loss | $(8,967 ) | (17.7 )% | $(12,304 ) | (28.3 )% | $3,337 | (27.1 )% |

| | Nine Months Ended September 30, 2015 | | 2014 | | Increase (Decrease) | |
|---|---|---|---|---|---|---|
| | Amount | Percent of Total Revenue | Amount | Percent of Total Revenue | Amount | Percent |
| Revenue: | | | | | | |
| Products | $98,837 | 69.4 % | $102,140 | 76.1 % | $(3,303) | (3.2)% |
| Services | 43,494 | 30.6 | 32,165 | 23.9 | 11,329 | 35.2 |
| Total revenue | 142,331 | 100.0 | 134,305 | 100.0 | 8,026 | 6.0 |
| Cost of revenue: | | | | | | |
| Products | 23,501 | 16.5 | 23,655 | 17.6 | (154) | (0.7) |
| Services | 11,601 | 8.2 | 8,491 | 6.3 | 3,110 | 36.6 |
| Total cost of revenue | 35,102 | 24.7 | 32,146 | 23.9 | 2,956 | 9.2 |
| Gross profit | 107,229 | 75.3 | 102,159 | 76.1 | 5,070 | 5.0 |
| Operating expenses: | | | | | | |
| Sales and marketing | 75,258 | 52.9 | 70,189 | 52.3 | 5,069 | 7.2 |
| Research and development | 41,542 | 29.2 | 35,416 | 26.4 | 6,126 | 17.3 |
| General and administrative | 20,122 | 14.1 | 16,035 | 11.9 | 4,087 | 25.5 |
| Litigation expense (benefit) | 1,939 | 1.4 | (3,103) | (2.3) | 5,042 | (162.5) |
| Total operating expenses | 138,861 | 97.6 | 118,537 | 88.3 | 20,324 | 17.1 |
| Loss from operations | (31,632) | (22.2) | (16,378) | (12.2) | (15,254) | 93.1 |
| Other income (expense), net: | | | | | | |
| Interest expense | (382) | (0.3) | (904) | (0.7) | 522 | (57.7) |
| Interest income and other income (expense), net | (167) | (0.1) | (673) | (0.5) | 506 | (75.2) |
| Total other income (expense), net | (549) | (0.4) | (1,577) | (1.2) | 1,028 | (65.2) |
| Loss before provision for income taxes | (32,181) | (22.6) | (17,955) | (13.4) | (14,226) | 79.2 |
| Provision for income taxes | 497 | 0.3 | 747 | 0.6 | (250) | (33.5) |
| Net loss | $(32,678) | (23.0)% | $(18,702) | (13.9)% | $(13,976) | 74.7 % |

Revenue

Our product revenue primarily consists of revenue from sales of our hardware appliances upon which our software is installed. Such software includes our ACOS software platform plus one of our ADC, CGN or TPS solutions. Purchase of a hardware appliance includes a perpetual license to the included software. We recognize product revenue at the time of shipment, provided that all other revenue recognition criteria have been met. As a percentage of revenue, our product revenue may vary from quarter to quarter based on, among other things, the timing of orders and delivery of products, cyclicality and seasonality, changes in currency exchange rates and the impact of significant transactions with unique terms and conditions.

We generate services revenue from sales of post contract support, or PCS, which is bundled with sales of products and professional services. We offer tiered PCS services under renewable, fee-based PCS contracts, primarily including technical support, hardware repair and replacement parts, and software upgrades on a when-and-if-released basis. We recognize services revenue ratably over the term of the PCS contract, which is typically one year, but can be up to five years. We expect our services revenue to increase in absolute dollars as we expand our installed base.

A summary of our total revenue for the three and nine months ended September 30, 2015 and 2014 is as follows (in thousands, except for percentages):

| | Three Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|
| | 2015 | 2014 | Amount | Percent |
| Revenue: | | | | |
| Products | $34,990 | $31,601 | $3,389 | 11% |
| Services | 15,788 | 11,827 | 3,961 | 33 |
| Total revenue | $50,778 | $43,428 | $7,350 | 17% |
| Revenue by geographic location: | | | | |
| United States | $25,059 | $20,445 | $4,614 | 23% |
| Japan | 8,764 | 9,893 | (1,129) | (11) |
| Asia Pacific, excluding Japan | 7,991 | 6,285 | 1,706 | 27 |
| EMEA | 7,317 | 4,940 | 2,377 | 48 |
| Other | 1,647 | 1,865 | (218) | (12) |
| Total revenue | $50,778 | $43,428 | $7,350 | 17% |

| | Nine Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|
| | 2015 | 2014 | Amount | Percent |
| Revenue: | | | | |
| Products | $98,837 | $102,140 | $(3,303) | (3)% |
| Services | 43,494 | 32,165 | 11,329 | 35 |
| Total revenue | $142,331 | $134,305 | $8,026 | 6% |
| Revenue by geographic location: | | | | |
| United States | $75,365 | $64,873 | $10,492 | 16% |
| Japan | 24,222 | 35,668 | (11,446) | (32) |
| Asia Pacific, excluding Japan | 18,122 | 14,960 | 3,162 | 21 |
| EMEA | 20,372 | 13,005 | 7,367 | 57 |
| Other | 4,250 | 5,799 | (1,549) | (27) |
| Total revenue | $142,331 | $134,305 | $8,026 | 6% |

Total revenue increased by $7.4 million in the third quarter of 2015 compared to the third quarter of 2014, which was comprised of a $3.4 million increase in product revenue and a $4.0 million increase in services revenue. Revenue from service

providers and enterprise customers increased 19% and 16%, respectively, in the third quarter of 2015 compared to the same period in 2014.

Product revenue increased $3.4 million, or 11%, in the third quarter of 2015 compared to the third quarter in 2014 which is primarily attributable to increases from the United States, EMEA and Asia Pacific, excluding Japan, largely due to higher product revenue from service provider customers. These revenue increases were partially offset by lower product revenue from Japan. Japan's product revenue decreased in the third quarter of 2015 compared to the same period in 2014 largely due to the impact of unfavorable currency exchange rate between the Japanese yen and the U.S. dollar and lower product revenues.

Services revenue increased $4.0 million, or 33% in the third quarter of 2015 compared to the same period in 2014 primarily attributable to the increase in PCS sales in connection with our increasing installed customer base as well as increases in our professional services revenue. Over 95% of our end-customers purchase one of our maintenance service products when purchasing our hardware products. During the third quarter of 2015, services revenue recognized from contracts existing prior to 2015 grew by 35% as compared to services revenue related to contracts existing prior to 2014.

During the third quarter of 2015, $25.1 million, or 49%, of total revenue was generated from the United States, which represents a 23% growth compared to the third quarter of 2014. This increase was primarily attributable to increased product revenue from service provider customers as well as higher PCS sales in connection with our increased installed customer base. We continue to see growth in our EMEA and Asia Pacific regions, excluding Japan. In the third quarter of 2015, total revenue from EMEA and Asia Pacific region, excluding Japan, increased 48% and 27%, respectively, compared to the third quarter of 2014, primarily due to our efforts to continue expanding our presence in these regions. During the third quarter of 2015, 17%, or $8.8 million of total revenue was generated from Japan, an 11% decrease compared to the third quarter of 2014, primarily due to lower product revenues. In addition, Japan's third quarter 2015 total revenue was also was more adversely impacted by the unfavorable currency exchange rate between the Japanese yen against the U.S. dollar compared to the same period in 2014.

Total revenue increased by $8.0 million in the first nine months of 2015 compared to the same period of 2014, which comprised of an $11.3 million increase in services revenue, partially offset by a $3.3 million decrease in product revenue. Revenue from enterprise customers increased 13% in the first nine months of 2015 compared to the same period in 2014. Revenue from service provider customers decreased 2% in the first nine months of 2015 compared to the same period in 2014.

Product revenue decreased $3.3 million, or 3%, in the first nine months of 2015 compared to the same period in 2014 which is primarily attributable to lower product revenue from Japan, partially offset by product revenue increases from the United States, EMEA and Asia Pacific, excluding Japan. In the first quarter of 2014, our product revenue from Japan was positively impacted by a higher backlog entering the quarter that resulted from strong demand for our products in Japan in the fourth quarter of 2013. In addition, Japan's total revenue was more adversely impacted by the unfavorable currency exchange rate between the Japanese yen against the U.S. dollar in the third quarter of 2015 compared to the same period in 2014.

Services revenue increased $11.3 million, or 35%, in the first nine months of 2015 compared to the same period in 2014, primarily attributable to the increase in PCS sales in connection with our increasing installed customer base, as well as increases in our professional services revenue. Over 95% of our end-customers purchase one of our maintenance service products when purchasing our hardware products. During the first nine months of 2015, services revenue recognized from contracts existing prior to 2015 grew by 36% as compared to services revenue related to contracts existing prior to 2014.

During the first nine months of 2015, 53%, or $75.4 million of total revenue was generated from the United States, which represents a 16% growth compared to the same period in 2014. This increase was primarily attributable to increased product revenue from service provider customers as well as higher PCS sales in connection with our increased installed customer base. We continue to see growth in our EMEA and Asia Pacific regions, excluding Japan, with total revenue increasing 57% and 21%, respectively, in the first nine months of 2015 compared to the same period of 2014, primarily due to our efforts to continue expanding our presence in these regions. During the first nine months of 2015, 17%, or $24.2 million of total revenue was generated from Japan, a 32% decrease compared to the same period in 2014 primarily due to lower product revenue as a result of the positive impact of higher backlog entering into 2014. This decrease was partially offset by an increase in services revenue. In addition, Japan's total revenue was more adversely impacted by the unfavorable currency exchange rate between the Japanese yen against the U.S. dollar during the first nine months of 2015 compared to the same period in 2014.

Cost of Revenue, Gross Profit and Gross Margin

Cost of revenue

A summary of our cost of revenue for the three and nine months ended September 30, 2015 and 2014 is as follows (in thousands, except for percentages):

| | Three Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|
| | 2015 | 2014 | Amount | Percent |
| Cost of revenue: | | | | |
| Products | $8,529 | $8,818 | $(289) | (3)% |
| Services | 4,186 | 2,935 | 1,251 | 43 |
| Total cost of revenue | $12,715 | $11,753 | $962 | 8% |

| | Nine Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|
| | 2015 | 2014 | Amount | Percent |
| Cost of revenue: | | | | |
| Products | $23,501 | $23,655 | $(154) | (1)% |
| Services | 11,601 | 8,491 | 3,110 | 37 |
| Total cost of revenue | $35,102 | $32,146 | $2,956 | 9% |

Gross Margin

Gross margin varies from period to period due to a variety of factors. These may include the mix of revenue from each of our regions, the mix of our products sold within a period, discounts provided to customers, inventory write-downs and foreign currency exchange rates.

Our sales are generally denominated in U.S. dollars, however, in Japan they are denominated in the Japanese yen. Changes in the exchange rates between the U.S. dollar and Japanese yen will therefore affect our revenue and gross margin. Any of the factors noted above can generate either a positive or negative impact on gross margin as compared to another period.

A summary of gross profit and gross margin for the three and nine months ended September 30, 2015 and 2014 is as follows (in thousands, except for gross margins and percentages):

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Increase (Decrease) | |
| | Amount | Gross Margin | Amount | Gross Margin | Amount | Gross Margin |
| Gross profit: | | | | | | |
| Products | $26,461 | 75.6% | $22,783 | 72.1% | $3,678 | 3.5% |
| Services | 11,602 | 73.5 | 8,892 | 75.2 | 2,710 | (1.7) |
| Total gross profit | $38,063 | 75.0% | $31,675 | 72.9% | $6,388 | 2.1% |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | Increase (Decrease) | |
| | Amount | Gross Margin | Amount | Gross Margin | Amount | Gross Margin |
| Gross profit: | | | | | | |
| Products | $75,336 | 76.2% | $78,485 | 76.8% | $(3,149) | (0.6)% |
| Services | 31,893 | 73.3 | 23,674 | 73.6 | 8,219 | (0.3) |
| Total gross profit | $107,229 | 75.3% | $102,159 | 76.1% | $5,070 | (0.8)% |

Products gross margin in the third quarter of 2015 increased by 3.5% compared to the same period in 2014 primarily due to improved product mix and a decrease in inventory reserves, partially offset by the impact of unfavorable exchange rates of Japanese yen against the U.S. dollar. In the third quarter of 2014, our products gross margins was negatively impacted due to an increase in our inventory reserves as a result of our end-customers adopting our new Thunder Series.

Products gross margin decreased 0.6% in the first nine months of 2015 compared to the same period in 2014 primarily due to the impact of unfavorable exchange rates of Japanese yen against the U.S. dollar partially offset by a favorable shift in our geographical sales mix. In addition, our products gross margins in the third quarter of 2015 were also negatively impacted by investments we made related to two Original Equipment Manufacturers ("OEM") opportunities.

We experienced higher sales volumes from geographic regions with generally higher gross margins during the third quarter and the first nine months of 2015 compared to the same periods in 2014, which had a positive impact on our gross margins for the three and nine months ended September 30, 2015. Our gross margin for the third quarter and the first nine months of 2015 was also impacted by unfavorable foreign exchange rates as the Japanese yen exchange rates continue to devalue against the U.S. dollar. We anticipate that our gross margin will continue to be impacted by these factors in subsequent periods.

Services gross margin decreased 1.7% and 0.3% in the three and nine months ended September 30, 2015 compared to the same periods in 2014, as a result of increases in cost of services partially offset by the growth in services revenue. The increase in cost of services was primarily a result of headcount increase as we continue to expand our services and support teams in anticipation of future growth in our installed base. Our services revenue recognized from our installed base with existing contracts prior to 2015 grew by 36% in the first nine months of 2015 compared to services revenue generated from contracts existing prior to 2014 during the first nine months of 2014.

Operating Expenses

Our operating expenses consist of sales and marketing, research and development, general and administrative and litigation. The largest component of our operating expenses is personnel costs which consist of wages, benefits, bonuses, and, with respect to sales and marketing expenses, sales commissions. Personnel costs also include stock-based compensation and travel expenses.

A summary of our operating expenses for the three and nine months ended September 30, 2015 and 2014 is as follows (in thousands, except for percentages):

| | Three Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|
| | 2015 | 2014 | Amount | Percent |
| Operating expenses: | | | | |
| Sales and marketing | $25,774 | $24,651 | $1,123 | 5% |

| | | | | |
|---|---|---|---|---|
| Research and development | 13,562 | 12,342 | 1,220 | 10 |
| General and administrative | 6,892 | 5,141 | 1,751 | 34 |
| Litigation expense | 469 | 910 | (441 ) | (48) |
| Total operating expenses | $46,697 | $43,044 | $3,653 | 8% |

| | Nine Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|
| | 2015 | 2014 | Amount | Percent |
| Operating expenses: | | | | |
| Sales and marketing | $75,258 | $70,189 | $5,069 | 7% |
| Research and development | 41,542 | 35,416 | 6,126 | 17 |
| General and administrative | 20,122 | 16,035 | 4,087 | 25 |
| Litigation expense (benefit) | 1,939 | (3,103) | 5,042 | (162) |
| Total operating expenses | $138,861 | $118,537 | $20,324 | 17% |

Sales and Marketing

Sales and marketing expenses are our largest functional category of total operating expenses. These expenses primarily consist of personnel costs related to our employees engaged in sales and marketing activities. Sales and marketing expenses also include the cost of marketing programs, trade shows, consulting services, promotional materials, demonstration equipment, depreciation and certain allocated facilities and information technology infrastructure costs.

Sales and marketing expenses increased $1.1 million, or 5%, in the third quarter of 2015 compared to the third quarter of 2014 primarily attributable to a $2.2 million increase in personnel related costs which includes a $1.0 million increase in sales commissions and a $0.4 million increase in stock-based compensation. The increase in personnel related costs was largely due to increased sales and marketing headcount and higher bonus attainment and sales commissions in the third quarter of 2015 compared to the same period in 2014. This increase was partially offset by a $0.4 million decrease in market development costs and a $0.4 million decrease in professional services and consultant fees.

Sales and marketing expenses increased $5.1 million, or 7%, in the first nine months of 2015 compared to the same period in 2014 primarily attributable to a $4.8 million increase in personnel related costs and a $0.7 million increase in company meeting expenses. The increase in personnel related costs, which includes a $2.3 million increase in sales commission and a $2.0 million increase in stock-based compensation was primarily attributable to increased sales and marketing headcount and higher bonus attainment and sales commissions in the first nine months of 2015 compared to the same period in 2014. These increases were partially offset by a $0.4 million decrease in trade show and market development costs.

We expect our sales and marketing expenses to continue to increase in absolute dollars in the future as we increase the size of our sales and marketing organization and as we increase our sales presence in existing countries and expand into new countries.

Research and Development

Research and development efforts are focused on new product development and on developing additional functionality
for our existing products. These expenses consist of personnel costs, and to a lesser extent, professional services, prototype materials, depreciation and certain allocated facilities and information technology infrastructure costs. We expense research and development costs as incurred.

Research and development expenses increased $1.2 million, or 10%, in the third quarter of 2015 compared to the third quarter of 2014 primarily attributable to a $1.6 million increase in personnel related costs, which includes a $0.4 million increase in stock-based compensation. The increase in personnel related costs was primarily attributable to higher salaries and benefits. This increase was partially offset by a $0.3 million decrease in depreciation expense as a

result of certain assets being fully depreciated.

Research and development expenses increased $6.1 million, or 17%, in the first nine months of 2015 compared to the same period in 2014 primarily attributable to a $7.3 million increase in personnel related costs, which includes a $1.8 million increase in stock-based compensation. The increase in personnel related costs was primarily attributable to higher salaries and benefits. The increase in personnel related research and development expense was partially offset by a $0.7 million decrease in professional services fees due to lower product certification related activities in the first nine months of 2015 compared to the same period in 2014 and a $0.6 million decrease in depreciation expense as a result of certain assets being fully depreciated.

We expect our research and development expenses to increase in absolute dollars in the future as we continue to develop new products and enhance our existing products.

General and Administrative

General and administrative expenses consist primarily of personnel costs, professional services fees and office costs. General and administrative personnel costs include executive, finance, human resources, information technology, facility and legal (excluding litigation) related expenses. Professional fees consist primarily of fees for outside accounting, tax, legal, recruiting and other administrative services.

General and administrative expenses increased $1.8 million, or 34%, for the third quarter of 2015 compared to the third quarter of 2014 primarily attributable to a $0.7 million increase in personnel related costs and a $0.9 million increase in bad debt expense.

General and administrative expenses increased $4.1 million, or 25%, for the first nine months of 2015 compared to the same period of 2014 primarily attributable to a $2.4 million increase in personnel related costs, a $1.1 million increase in professional services cost and a $1.8 million increase in bad debt expense. These increases were partially offset by a $1.1 million decrease in sales and use tax expense largely as a result of the completion of several state sales tax registration processes and adjustments resulting from our reassessment of previously accrued sales and use tax liabilities.

The increase in personnel related costs in the three and nine months ended September 30, 2015 compared to the same periods in 2014 was a result of higher general and administrative headcount and increased salaries and benefits.

Based on management’s assessment and historical collection experience with our customer base, we recorded $0.6 million and $1.1 million of bad debt expense during the three and nine months ended September 30, 2015 compared to a reduction of $0.3 million and $0.7 million in bad debt expense in each of the three and nine months ended September 30, 2014.

The increase in professional services fees in the first nine months of 2015 compared to the same period in 2014 was primarily related to increased general legal and consultant fees in connection with scaling our organization to support increased business activity and costs associated with being a public company.

We expect our general and administrative expenses to increase slightly in the future.

Litigation Expense

Litigation expense is comprised of legal expenses incurred related to litigation and, if applicable, charges for litigation reserves. Litigation expenses consist of professional fees incurred in defending ourselves against litigation matters and are expensed as incurred when professional services are provided. The litigation reserve, if any, consists of accruals we make related to estimated losses in pending legal proceedings. Litigation reserves, if any, are adjusted as we change our estimates or make payments in damages or settlements.

Litigation expense decreased $0.4 million for the third quarter of 2015 compared to the third quarter of 2014 primarily attributable to a reduction in litigation related activities.

Litigation expense increased $5.0 million in the first nine months of 2015 compared to the same period of 2014 primarily attributable to the $7.0 million litigation benefit recognized in the second quarter of 2014 following a settlement agreement in May 2014 with one of our legal services providers which resulted in the reduction of a previously accrued contractual liability, partially offset by a $2.0 million decrease in other litigation expense largely attributable to a reduction in litigation related activities in the first nine months of 2015 compared to the same period in 2014.

Interest Expense

Interest expense decreased by $0.5 million in the first nine months of 2015 compared to the same period in 2014, primarily due to lower borrowing related activities in the first nine months of 2015 compared to the same period in 2014. During the first nine months of 2014, we recorded a $0.3 million contingent payment due to a lender upon completion of our initial public offering and $0.2 million of interest expense related to our revolving credit facility. We completed our initial public offering and repaid the outstanding balance under our revolving credit facility in March 2014.

Interest Income and Other Income (Expense), Net

Interest income and other income (expense), net, increased by $0.5 million in the third quarter of 2015 compared to the same period in 2014 primarily due to a $0.5 million decrease in foreign exchange losses. Interest income and other income (expense), net, increased by $0.5 million in the first nine months of 2015 compared to the same period in 2014 primarily due to a $0.4 million decrease in foreign exchange losses.
The Japanese yen exchange rates declined significantly against the U.S dollar in 2014, which resulted in $0.5 million and $0.4 million in increased foreign exchange losses during the three and nine months of 2014.

Provision for Income Taxes

We recorded an income tax provision of $0.2 million and $0.5 million for the three and nine months ended September 30, 2015, and $0.2 million and $0.7 million for the three and nine months ended September 30, 2014, which was primarily due to state and foreign taxes. We maintain a valuation allowance on federal and state deferred tax assets as we do not believe it is more likely than not that said deferred tax assets will be realized. We will continue to maintain a full valuation allowance on our deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of this allowance.

Liquidity and Capital Resources

As of September 30, 2015, we had cash and cash equivalents of $100.5 million, including $2.3 million held outside the United States in our foreign subsidiaries. We currently do not have any plans to repatriate our earnings from our foreign operations. As of September 30, 2015, we had working capital of $91.0 million, accumulated deficit of $214.5 million and total stockholders' equity of $80.9 million.

We plan to continue to invest for long-term growth and anticipate our investment will continue to increase in absolute dollars. We believe that our existing cash and cash equivalents and other available financial resources will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including our growth rate, the expansion of sales and marketing activities, the timing and extent of spending to support development efforts, the introduction of new and enhanced product and service offerings and the continuing market acceptance of our products. In the event that additional financing is required from outside sources, we may not be able to raise such financing on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition could be adversely affected.

In addition, as described in Note 5. Commitments and Contingencies, we are currently involved in ongoing litigation. Any adverse settlements or judgments in any litigation could have a material adverse impact on our results of operations, cash balances and cash flows in the period in which such events occur.

Credit Agreement

In September 2013, we entered into a credit agreement with Royal Bank of Canada, acting as administrative agent and lender, and JPMorgan Chase Bank, N.A. and Bank of America, N.A. as lenders. The credit agreement provides a three-year $35.0 million revolving credit facility, which includes a maximum $10.0 million letter of credit facility. The revolving credit facility expires on September 30, 2016.

Our obligations under the credit agreement are secured by a security interest on substantially all of our assets, including our intellectual property. The credit agreement contains customary non-financial covenants, and also requires us to comply with financial covenants. One financial covenant requires us to maintain a total leverage ratio,

which is defined as total consolidated debt divided by adjusted EBITDA (defined as earnings before interest expense, tax expense, depreciation, amortization and stock-based compensation, adjusted for certain other non-cash or non-recurring income or expenses such as specified litigation settlement payments and litigation expenses) for the trailing four quarters. In addition, we must maintain a minimum amount of liquidity based on our unrestricted cash and availability under the revolving credit facility. The covenant requires us to maintain a minimum liquidity of $25.0 million provided that at least $10.0 million of such liquidity is comprised of unrestricted cash and cash equivalents. The credit agreement includes customary events of default which, if triggered, could result in the acceleration of our obligations under the revolving credit facility, the termination of any obligation by the lenders to extend further credit and the right of the lenders to exercise their remedies as a secured creditor and foreclose upon the collateral securing our obligation under the credit agreement; however, we also have the ability, in certain instances, to cure

non-compliance with the financial covenants through qualified equity contributions by certain holders of our equity. Currently, the agreement for our revolving credit facility contains restrictions on our ability to pay dividends. As of September 30, 2015, we had no outstanding balance on our credit facility and were in compliance with our covenants.

Statements of Cash Flows

The following table summarizes our cash flow related activities for the nine months ended September 30, 2015 and 2014 (in thousands):

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2015 | 2014 |
| Cash provided by (used in): | | |
| Operating activities | $7,633 | $(13,521) |
| Investing activities | (2,558) | (5,380) |
| Financing activities | 3,544 | 105,207 |
| Net increase in cash and cash equivalents | $8,619 | $86,306 |

Cash Flows from Operating Activities

Our cash used in operating activities is driven primarily by sales of our products and, to a lesser extent, by up-front payments from end-customers under PCS contracts. Our primary uses of cash from operating activities have been for personnel-related expenditures, manufacturing costs, marketing and promotional expenses, costs related to our facilities and litigation expenses. Our cash flows from operating activities will continue to be affected principally by the extent to which we increase spending on personnel and sales and marketing activities, our working capital requirements, and litigation expenses.

During the nine months ended September 30, 2015, cash provided by operating activities was $7.6 million, consisting of a net loss of $32.7 million partially offset by non-cash charges of $21.6 million and an $18.7 million cash increase that resulted from changes in net operating assets and liabilities. Our non-cash charges consisted of $13.2 million of stock-based compensation, $6.8 million of depreciation and amortization and $1.6 million in provision for doubtful accounts and sales returns allowance. The changes in our net operating assets and liabilities were primarily attributable to an $11.2 million decrease in accounts receivable, a $9.1 million increase in deferred revenue, and a $0.9 million decrease in inventory, partially offset by a $2.6 million decrease in accounts payable and accrued liabilities.

The decrease in accounts receivable was primarily due to improved cash collection in 2015 and the timing of billing, as a higher portion of the December 31, 2014 outstanding accounts receivable were billed during the latter part of the quarter compared to the September 30, 2015 outstanding accounts receivable. The increase in deferred revenue was due to timing of billings of support contracts, the increase in PCS sales in connection with our increasing installed customer base and an increase in deferred professional services revenue. The decrease in inventory was primarily due to increased consumption of existing inventory. The decrease in accounts payable and accrued liabilities was primarily attributable to a decrease in accrued compensation costs largely due to the payment of accrued commissions and bonuses and the timing of vendor invoice payments.
During the nine months ended September 30, 2014, cash used in operating activities was $13.5 million, consisting of a net loss of $18.7 million and a $3.5 million increase in net operating assets and liabilities offset by non-cash charges of $8.7 million. Our non-cash charges consisted primarily of stock-based compensation of $8.3 million and depreciation and amortization of $7.3 million, partially offset by a $7.0 million gain on settlement of a contractual liability. The change in our net operating assets and liabilities was primarily due to a $6.8 million decrease in accrued litigation expenses, a $6.3 million increase in inventory, a $4.8 million increase in accounts receivable and a $3.3 million increase in prepaid expenses and other current assets, partially offset by a $9.7 million increase in deferred revenue and an $8.2 million increase in accounts payable and accrued liabilities.

The decrease in accrued litigation costs was primarily due to the $5.0 million payment we made under the terms of a settlement of a contractual liability we reached with one of our legal services providers in May 2014 as well as lower litigation activities in the nine months ended September 30, 2014 compared to the same period in 2013. The increase in inventory and prepaid and other current assets was attributable to our year over year business growth. The increase in accounts receivable was primarily due to increased billing and the timing of billing and cash collection, as a higher portion of the September 30, 2014 outstanding accounts receivable were billed during the latter part of the quarter compared to the December 31, 2013 outstanding accounts receivable. The increase in accounts payable and accrued liabilities was primarily attributable to increases in accrued compensation costs due to higher headcount and increases in accounts payable and other accrued liabilities

as a result of increased business activity levels and the timing of vendor invoice payments. The increase in deferred revenue was due to billings of support contracts with service terms that are typically one year.

Cash Flows from Investing Activities

During the nine months ended September 30, 2015 and 2014, cash used in investing activities was $2.6 million and $5.4 million, primarily for purchases of property and equipment.

Cash Flows from Financing Activities

During the nine months ended September 30, 2015, cash provided by financing activities was $3.5 million, consisting of proceeds from common stock issuance under our equity incentive plans, net of repurchases of common stock. During the nine months ended September 30, 2014, cash provided by financing activities was $105.2 million, primarily consisting of $121.0 million in net proceeds from the issuance of our common stock to outside investors in our IPO, and $4.4 million from the exercise of common stock options, net of repurchases of common stock, partially offset by a $20.0 million repayment of our revolving credit facility.

Contractual Obligations

In September 2013, we entered into a credit agreement with Royal Bank of Canada, JPMorgan Chase Bank, N.A. and Bank of America, N.A. as lenders. The credit agreement provides a three-year $35.0 million revolving credit facility, which includes a maximum $10.0 million letter of credit facility. We have no outstanding borrowings under this credit facility as of September 30, 2015.

Off-Balance Sheet Arrangements

As of September 30, 2015, we did not have any relationships with any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

There were no significant changes in our critical accounting policies and estimates during the nine months ended September 30, 2015 as compared to the critical accounting policies and estimates disclosed in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K filed with the SEC on March 11, 2015.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Foreign Currency Risk

Our consolidated results of operations, financial position and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. Historically, the majority of our revenue contracts are denominated in U.S. dollars,

with the most significant exception being Japan where we invoice primarily in the Japanese yen. Our costs and expenses are generally denominated in the currencies where our operations are located, which is primarily in North America, Japan and to a lesser extent EMEA and the Asia Pacific region. To date, we have not entered into any hedging arrangements with respect to foreign currency risk or other derivative instruments. Revenue resulting from selling in local currencies and costs and expenses incurred in local currencies are exposed to foreign currency exchange rate fluctuations which can affect our revenue and operating income. As exchange rates vary, operating income may differ from expectations.

The functional currency of our foreign subsidiaries is the U.S. dollar. At the end of each reporting period, monetary assets and liabilities are remeasured to the functional currency using exchange rates in effect at the balance sheet date. Nonmonetary assets and liabilities are remeasured at historical exchange rates. Gains and losses related to remeasurement are recorded in interest income and other income (expense), net in the Consolidated Statements of Operations. A significant fluctuation in the exchange rates between our subsidiaries' local currencies, especially the Japanese yen and the Euro, and the U.S. dollar could have an adverse impact on our consolidated financial position and results of operations.

We recorded $0.3 million and $0.7 million foreign exchange loss during the nine months ended September 30, 2015 and 2014. The effect of a hypothetical 10% change in our exchange rate would not have a significant impact on our consolidated results of operations.

We do not yet have any hedging programs in place to limit the risk of exchange rate fluctuation. In the future, however, to the extent our foreign currency exposures become more material, we may elect to deploy normal and customary hedging practices designed to more proactively mitigate such exposure.

Interest Rate Sensitivity

Our exposure to market risk for changes in interest rates relates primarily to our cash and cash equivalents and our indebtedness. Our cash and cash equivalents are held in cash deposits and money market funds with maturities of less than 90 days from the date of purchase. Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of the interest rates in the United States. However, because of the short-term nature of the instruments in our portfolio, a sudden change in market interest rates would not be expected to have a material impact on our consolidated financial statements.

Our exposure to interest rate risk relates to our revolving credit facility with variable interest rates, where an increase in interest rates may result in higher borrowing costs. Since we have no outstanding borrowings under our credit facility as of September 30, 2015, the effect of a hypothetical 10% change in interest rates would not have a significant impact on our interest expense.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures, as required by Rule 13a-15(b) under the Securities Exchange Act of 1934 as amended (the “Exchange Act”), as of September 30, 2015. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of September 30, 2015 solely due to the material weakness in our internal control over financial reporting as described below.

Changes in Internal Control over Financial Reporting

Through September 30, 2015, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, have evaluated whether there were any changes in our internal control over financial reporting since December 31, 2014. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that no changes in our internal control over financial reporting occurred during the three months ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, except as described below with regards to computation of stock-based compensation related to our 2014 Purchase Plan.

As discussed in Item 9A. Controls and Procedures in our Annual Report on Form 10-K for the year ended December 31, 2014, management identified a material weakness in our internal control over financial reporting as it relates to the computation of stock-based compensation associated with our 2014 Purchase Plan.

In response to the material weakness described above, during the three months ended September 30, 2015, we continued to evaluate new controls and procedures. Though management is still evaluating the effectiveness of these new procedures, we believe that our improved processes and procedures will lead to the remediation of the material weakness by the end of 2015. Once placed in operation for a sufficient period of time, we will subject these procedures to appropriate tests, in order to determine whether they are operating effectively. In designing and evaluating the stock-based compensation controls

and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Management has implemented the following steps during the first nine months of 2015:

- We added a control activity where we will consult with technical accounting experts to review and analyze the impact of new or unusual accounting transactions and the adoption of new accounting standards that may have a material impact on our consolidated financial statements.

- We strengthened our processes in the area of equity administration and equity accounting, which included the review, redesign and documentation of our policies and procedures; implementation of additional review and reconciliation controls, and expanded the use of software based solutions to handle certain aspects of accounting for stock-based compensation related to the 2014 Purchase Plan.

We will continue to evaluate the effectiveness of our internal controls and procedures on an ongoing basis and will take further action, as appropriate.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We have been and may currently be involved in various legal proceedings, the outcomes of which are not within our complete control or may not be known for prolonged periods of time. Management is required to assess the probability of loss and amount of such loss, if any, in preparing our consolidated financial statements. We evaluate the likelihood of a potential loss from legal proceedings to which we are a party. We record a liability for such claims when a loss is deemed probable and the amount can be reasonably estimated. Significant judgment may be required in the determination of both probability and whether an exposure is reasonably estimable. Our judgments are subjective based on the status of the legal proceedings, the merits of our defenses and consultation with in-house and outside legal counsel. As additional information becomes available, we reassess the potential liability related to pending claims and may revise our estimates. Due to the inherent uncertainties of the legal processes in the multiple jurisdictions in which we operate, our judgments may be materially different than the actual outcomes, which could have material adverse effects on our business, financial conditions and results of operations.

Additional information with respect to this Item may be found in Note 5. Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q, which is incorporated into this Item 1 by reference.

### ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information contained in this report, and in our other public filings. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that affect us. If any of the following risks occur, our business, financial condition, operating results, and prospects could be materially harmed. In that event, the trading price of our common stock could decline, perhaps significantly.

If we do not successfully anticipate market needs and opportunities or if the market does not continue to adopt our application networking products, our business, financial condition and results of operations could be significantly harmed.

The application networking market is rapidly evolving and difficult to predict. Technologies, customer requirements, security threats and industry standards are constantly changing. As a result, we must anticipate future market needs and opportunities and then develop new products or enhancements to our current products that are designed to address those needs and opportunities, and we may not be successful in doing so.

Even if we are able to anticipate, develop and commercially introduce new products and enhancements that address the market's needs and opportunities, there can be no assurance that new products or enhancements will achieve widespread market acceptance. For example, organizations that use other conventional or first-generation application networking products for their needs may believe that these products are sufficient. In addition, as we launch new product offerings, organizations

may not believe that such new product offerings offer any additional benefits as compared to the existing application networking products that they currently use. Accordingly, organizations may continue allocating their IT budgets for existing application networking products and may not adopt our products, regardless of whether our products can offer superior performance or security.

If we fail to anticipate market needs and opportunities or if the market does not continue to adopt our application networking products, then market acceptance and sales of our current and future application networking products could be substantially decreased or delayed, we could lose customers, and our revenue may not grow or may decline. Any of such events would significantly harm our business, financial condition and results of operations.

Our success depends on our timely development of new products and features to address rapid technological changes and evolving customer requirements. If we are unable to timely develop new products and features that adequately address these changes and requirements, our business and operating results could be adversely affected.

Changes in application software technologies, data center and communications hardware, networking software and operating systems, and industry standards, as well as our end-customers’ continuing business growth, result in evolving application networking needs and requirements. Our continued success depends on our ability to identify and develop in a timely manner new products and new features for our existing products that meet these needs and requirements.

Our future plans include significant investments in research and development and related product opportunities. Developing our products and related enhancements is time-consuming and expensive. We have made significant investments in our research and development team in order to address these product development needs. Our investments in research and development may not result in significant design and performance improvements or marketable products or features, or may result in products that are more expensive than anticipated. We may take longer to generate revenue, or generate less revenue, than we anticipate from our new products and product enhancements. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position.

If we are unable to develop new products and features to address technological changes and new customer requirements in the application networking market or if our investments in research and development do not yield the expected benefits in a timely manner, our business and operating results could be adversely affected.

We have experienced net losses in recent periods, anticipate increasing our operating expenses in the future and may not achieve or maintain profitability in the future. If we cannot achieve or maintain profitability, our financial performance will be harmed and our business may suffer.

We experienced net losses for the years ended December 31, 2013 and 2014, and nine months ended September 30, 2015. Although we experienced revenue growth over these same periods and had achieved profitability in prior year periods, we may not be able to sustain or increase our revenue growth or achieve profitability in the future or on a consistent basis. During 2013 and 2014, we invested in our sales, marketing and research and development teams in order to develop, market and sell our products. We expect to continue to invest significantly in these areas in the future. As a result of these increased expenditures, we will have to generate and sustain increased revenue, manage our cost structure and avoid significant liabilities to achieve future profitability. In particular, in 2012 and 2013, we incurred substantial expenses associated with defending ourselves in separate litigation matters involving Brocade Communications Systems, Inc. and Radware Ltd. (both settled) and in our settlement of the Brocade litigation. As a public company, we are also incurring significant accounting, legal and other expenses that we did not incur as a private company.

Revenue growth may slow or decline, and we may incur significant losses in the future for a number of possible reasons, including our inability to develop products that achieve market acceptance, general economic conditions,

increasing competition, decreased growth in the markets in which we operate, or our failure for any reason to capitalize on growth opportunities. Additionally, we may encounter unforeseen operating expenses, difficulties, complications, delays and other unknown factors that may result in losses in future periods. If these losses exceed our expectations or our revenue growth expectations are not met in future periods, our financial performance will be harmed and our stock price could be volatile or decline.

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

Our operating results, in particular, revenue, margins and operating expenses, have fluctuated in the past, and we expect this will continue, which makes it difficult for us to predict our future operating results. The timing and size of sales of our products are highly variable and difficult to predict and can result in significant fluctuations in our revenue from period to period. This is particularly true of sales to our largest end-customers, such as service providers, Web giants and governmental organizations, who typically make large and concentrated purchases and for whom close or sales cycles can be long, as a result of their complex networks and data centers, as well as requests that may be made for customized features. Our quarterly results may vary significantly based on when these large end-customers place orders with us and the content of their orders. For example, during the three months ended September 30, 2014, we experienced a decline in our revenues primarily due to longer than expected close or sales cycles for certain large deals and lower North America service provider spending as compared to the same period in 2013, which may have contributed to a dramatic decline in our stock price. We anticipate a possible slowdown in spending from North America service providers, which may lead to continued near term fluctuation in our product revenue and total revenue.

Our operating results may also fluctuate due to a number of other factors, many of which are outside of our control and may be difficult to predict. In addition to other risks listed in this “Risk Factors” section, factors that may affect our operating results include:

- fluctuations in and timing of purchases from, or loss of, large customers;

- the budgeting cycles and purchasing practices of end-customers;

- our ability to attract and retain new end-customers;

- changes in demand