Zendesk, Inc.
Form 10-Q
August 03, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
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: 001-36456

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

Delaware	26-4411091
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1019 Market Street San Francisco, CA	94103
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (415) 418-7506

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer
Non-accelerated filer (do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act.
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 July 31, 2018, there were 105,958,810 shares of the registrant’s common stock outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of federal securities laws, which statements involve substantial risks and uncertainties. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “should,” “might,” “expects,” “plans,” “anticipates,” “could,” “i “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential,” or “continue,” or the negative of these wo other similar terms or expressions that concern our expectations, strategy, plans, or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our future financial performance, including our revenue, cost of revenue, gross profit, operating expenses, ability to generate positive cash flow, and ability to achieve and maintain profitability;
- the sufficiency of our cash and cash equivalents and marketable securities to meet our liquidity needs;
- our ability to attract and retain customers to use our products, and our ability to optimize the pricing for such products;
- the evolution of technology affecting our products, services, and markets;
- our ability to innovate and provide a superior customer experience;
- our ability to successfully expand in our existing markets and into new markets;
- the attraction and retention of qualified employees and key personnel;
- worldwide economic conditions and their impact on information technology spending;
- our ability to effectively manage our growth and future expenses;
- our ability to introduce and market new products and to integrate such products into our infrastructure;
- our ability to maintain, protect, and enhance our intellectual property;
- our ability to comply with modified or new laws and regulations applying to our business, including privacy and data security regulations;
- our ability to securely maintain customer data;
- our ability to service the interest on our convertible notes and repay such notes, if required;
- our ability to maintain and enhance our brand; and
- the increased expenses and administrative workload associated with being a public company.

We caution you that the foregoing list does not contain all of the forward-looking statements made in this Quarterly Report on Form 10-Q.

You should not rely upon forward-looking statements as predictions of future events. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, operating results, and prospects. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties, and other factors described in the section titled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. We cannot assure you that the results, events, and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events, or circumstances could differ materially from those described in the forward-looking statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions, or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures, or investments we may make.

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PART I — FINANCIAL INFORMATION
Item 1. Financial Statements
ZENDESK, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value and shares)

	June 30, 2018 (Unaudited)	December 31, 2017 * As adjusted
Assets		
Current assets:		
Cash and cash equivalents	$492,752	$109,370
Marketable securities	191,503	137,576
Accounts receivable, net of allowance for doubtful accounts of $2,478 and $1,252 as of June 30, 2018 and December 31, 2017, respectively	69,419	57,096
Deferred costs	19,335	15,771
Prepaid expenses and other current assets	31,170	24,165
Total current assets	804,179	343,978
Marketable securities, noncurrent	188,770	97,447
Property and equipment, net	69,426	59,157
Deferred costs, noncurrent	20,250	15,395
Goodwill and intangible assets, net	65,647	67,034
Other assets	10,813	8,359
Total assets	$1,159,085	$591,370
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$14,229	$5,307
Accrued liabilities	39,481	21,876
Accrued compensation and related benefits	33,612	29,017
Deferred revenue	206,456	173,147
Total current liabilities	293,778	229,347
Convertible senior notes, net	446,060	—
Deferred revenue, noncurrent	1,504	1,213
Other liabilities	12,877	6,626
Total liabilities	754,219	237,186
Commitments and contingencies (Note 8)		
Stockholders’ equity:		
Preferred stock	—	—
Common stock	1,056	1,031
Additional paid-in capital	871,343	753,568
Accumulated other comprehensive loss	(5,799)	(2,372)
Accumulated deficit	(461,734)	(398,043)
Total stockholders’ equity	404,866	354,184
Total liabilities and stockholders’ equity	$1,159,085	$591,370

* See Note 1 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017 *As adjusted	2018	2017 *As adjusted
Revenue	$141,882	$102,096	$271,673	$195,984
Cost of revenue (1)	44,160	30,663	83,216	58,770
Gross profit	97,722	71,433	188,457	137,214
Operating expenses (1):				
Research and development	37,624	28,698	74,708	55,154
Sales and marketing	69,450	50,412	134,508	96,681
General and administrative	24,245	19,788	46,452	38,105
Total operating expenses	131,319	98,898	255,668	189,940
Operating loss	(33,597)	(27,465)	(67,211)	(52,726)
Other income (expense), net				
Interest income	3,826	827	5,344	1,540
Interest expense	(6,289)	—	(7,053)	—
Other income (expense), net	27	(319)	272	(814)
Total other income (expense), net	(2,436)	508	(1,437)	726
Loss before benefit from income taxes	(36,033)	(26,957)	(68,648)	(52,000)
Benefit from income taxes	(1,667)	(690)	(4,957)	(652)
Net loss	$(34,366)	$(26,267)	$(63,691)	$(51,348)
Net loss per share, basic and diluted	$(0.33)	$(0.26)	$(0.61)	$(0.52)
Weighted-average shares used to compute net loss per share, basic and diluted	105,000	99,506	104,350	98,545

(1) Includes share-based compensation expense as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017 * As adjusted	2018	2017 * As adjusted
Cost of revenue	$3,474	$ 2,156	$6,572	$ 4,260
Research and development	9,529	7,584	19,758	14,498
Sales and marketing	9,178	5,884	17,186	11,408
General and administrative	5,967	5,321	11,619	9,883

* See Note 1 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017 * As adjusted	2018	2017 * As adjusted
Net loss	$(34,366)	$(26,267)	$(63,691)	$(51,348)
Other comprehensive gain (loss), before tax:				
Net unrealized gain (loss) on available-for-sale investments	13	13	(623)	132
Foreign currency translation gain (loss)	—	249	(12)	824
Net unrealized gain (loss) on derivative instruments	(3,132)	1,822	(3,874)	3,348
Other comprehensive gain (loss), before tax	(3,119)	2,084	(4,509)	4,304
Tax effect	1,082	(766)	1,082	(1,582)
Other comprehensive gain (loss), net of tax	(2,037)	1,318	(3,427)	2,722
Comprehensive loss	$(36,403)	$(24,949)	$(67,118)	$(48,626)

* See Note 1 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2018	2017 * As adjusted
Cash flows from operating activities		
Net loss	$(63,691)	$(51,348)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	18,663	16,132
Share-based compensation	55,135	40,049
Amortization of deferred costs	9,530	6,598
Amortization of debt discount and issuance costs	6,650	—
Other	2,299	359
Changes in operating assets and liabilities:		
Accounts receivable	(13,896)	(4,619)
Prepaid expenses and other current assets	(7,425)	(2,853)
Deferred costs	(17,579)	(9,609)
Other assets and liabilities	(9,311)	(3,404)
Accounts payable	10,266	3,809
Accrued liabilities	11,576	4,188
Accrued compensation and related benefits	4,120	1,394
Deferred revenue	33,601	16,881
Net cash provided by operating activities	39,938	17,577
Cash flows from investing activities		
Purchases of property and equipment	(20,036)	(9,276)
Internal-use software development costs	(4,161)	(3,315)
Purchases of marketable securities	(249,011)	(82,325)
Proceeds from maturities of marketable securities	94,580	61,686
Proceeds from sales of marketable securities	8,848	20,743
Cash paid for the acquisition of Outbound, net of cash acquired	—	(16,470)
Net cash used in investing activities	(169,780)	(28,957)
Cash flows from financing activities		
Proceeds from issuance of convertible senior notes, net of issuance costs paid of $13,506	561,493	—
Purchase of capped call related to convertible senior notes	(63,940)	—
Proceeds from exercises of employee stock options	9,747	15,175
Proceeds from employee stock purchase plan	9,949	7,139
Other	(3,862)	(1,763)
Net cash provided by financing activities	513,387	20,551
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(36)	279
Net increase in cash, cash equivalents and restricted cash	383,509	9,450
Cash, cash equivalents and restricted cash at beginning of period	110,888	95,062
Cash, cash equivalents and restricted cash at end of period	$494,397	$104,512

Reconciliation of cash, cash equivalents and restricted cash to condensed consolidated balance sheets

Cash and cash equivalents	$492,752	$102,775
Restricted cash included in prepaid expenses and other current assets	1,021	1,100
Restricted cash included in other assets	624	637
Total cash, cash equivalents and restricted cash	$494,397	$104,512
Supplemental cash flow data		
Cash paid for income taxes and interest	$1,545	$756
Non-cash investing and financing activities		
Balance of property and equipment in accounts payable and accrued expenses	$4,921	$3,036
Property and equipment acquired through tenant improvement allowances	$4,261	$—
Share-based compensation capitalized in internal-use software development costs	$1,499	$1,306
Estimated convertible senior notes offering costs incurred but not yet paid	$55	$—
Vesting of early exercised stock options	$—	$224

*See Note 1 for a summary of adjustments.

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See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Overview and Basis of Presentation

Company and Background

Zendesk was founded in Denmark in 2007 and reincorporated in Delaware in April 2009.

We are a software development company that provides software as a service, or SaaS, products that are intended to help organizations and their customers build better relationships. With our origins in customer service, we have evolved our offerings over time to a family of products that work together to help organizations understand their customers, improve communications, and engage where and when it’s needed most. Our product family is built upon a modern architecture that enables us and our customers to rapidly innovate, adapt our technology in novel ways, and easily integrate with other products and applications.

References to Zendesk, the “Company,” “our,” or “we” in these notes refer to Zendesk, Inc. and its subsidiaries on a consolidated basis.

Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP, and applicable rules and regulations of the Securities and Exchange Commission, or SEC, regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 22, 2018. There have been no changes to our significant accounting policies described in the Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes, except as described below.

Effective January 1, 2018, we adopted the requirements of Accounting Standards Update, or ASU, 2014-09, “Revenue from Contracts with Customers” regarding Accounting Standards Codification, or ASC, Topic 606 and ASU 2016-18, “Statement of Cash Flows, Restricted Cash,” as discussed below. All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standards, as indicated by “as adjusted.”

The unaudited consolidated balance sheet as of December 31, 2017 included herein was derived from the audited financial statements as of that date, giving effect to the adoption of ASC 606, as discussed below. The unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly our financial position, results of operations, comprehensive loss, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2018.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make certain estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reported periods.

Significant items subject to such estimates and assumptions include the fair value of share-based awards, acquired intangible assets, and goodwill as well as unrecognized tax benefits, the useful lives of acquired intangible assets and property and equipment, the capitalization and estimated useful life of capitalized costs to obtain customer contracts and capitalized internal-use software, variable consideration related to revenue recognition, and financial forecasts used in currency hedging.

These estimates are based on information available as of the date of the financial statements; therefore, actual results could differ from those estimates.

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Concentrations of Risk

As of June 30, 2018, no customers represented 10% or greater of our total accounts receivable balance. There were no customers that individually exceeded 10% of our revenue during the three and six months ended June 30, 2018 or 2017.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board, or FASB, issued ASU 2016-02, regarding ASC Topic 842 “Leases,” including subsequent amendments. This new guidance requires lessees to recognize most leases on their balance sheets as right-of-use assets with corresponding lease liabilities and eliminates certain real estate-specific provisions. The new guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We have completed our process to identify our population of lease arrangements and we are applying the new guidance to each arrangement. While the adoption remains in progress, we expect that adoption will result in the recognition of right-of-use assets and lease liabilities that were not previously recognized, which will increase total assets and liabilities on our consolidated balance sheet.

In August 2017, the FASB issued ASU 2017-12, regarding ASC Topic 815 “Derivatives and Hedging.” This amendment simplifies various aspects of hedge accounting, including measurement and presentation of hedge ineffectiveness and certain documentation and assessment requirements. The amendment also makes more hedging strategies eligible for hedge accounting. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We are currently evaluating the effect of this standard on our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, “Income Statement - Reporting Comprehensive Income,” which provides for the reclassification of the effect of remeasuring deferred tax balances related to items within accumulated other comprehensive income to retained earnings resulting from the Tax Cuts and Jobs Act, or Tax Act. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We are currently evaluating the effect of this standard on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, regarding ASC Topic 718 “Compensation - Stock Compensation,” which largely aligns the accounting for share-based compensation for non-employees with employees. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-08, regarding ASC Topic 958 “Not-for-Profit Entities,” which clarified the guidance on how entities determine whether to account for a transfer of assets as an exchange transaction or a contribution. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our consolidated financial statements.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued new revenue guidance under ASU 2014-09 that provides principles for recognizing revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for the promised goods or services provided to customers. ASC 606 and ASC 340-40 also require the deferral of incremental costs of obtaining contracts with customers and subsequent amortization of those costs over the period of anticipated benefit. Collectively, we refer to this guidance as “ASC 606.” We adopted ASC 606 on January 1, 2018, utilizing the full retrospective method of transition. The adoption resulted in changes to our accounting policies for revenue recognition and incremental costs to acquire contracts, as described below. We applied ASC 606 using the following practical expedients:

- consideration allocated to the remaining performance obligations and an explanation of when we expect to recognize that amount as revenue is not disclosed for comparative periods prior to the adoption date;

- completed contracts that included variable consideration utilize the final transaction price rather than an estimation of variable consideration for comparative periods prior to the adoption date; and

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- costs of obtaining contracts with customers are expensed when the amortization period would have been one year or less.

The effect of adopting ASC 606 on our 2017 and 2016 revenues was not material. The primary effect relates to the deferral of sales commissions and other incremental costs to acquire contracts, which we historically expensed as incurred. The impact of adoption is summarized in the tables below. Under ASC 606, all incremental costs to acquire contracts are capitalized and amortized on a straight-line basis over the anticipated period of benefit, which we have determined to be three years.

In August 2016, the FASB issued ASU 2016-15, regarding ASC Topic 230 “Statement of Cash Flows.” This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The new guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. We adopted this standard in the first quarter of 2018. The adoption did not have an effect on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows - Restricted Cash,” which requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. We adopted this standard in the first quarter of 2018 on a retrospective basis, resulting in an immaterial change to our previously reported statement of cash flows for the six months ended June 30, 2017, which is summarized in the table below.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations - Clarifying the Definition of a Business,” which clarifies the definition of a business when evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. We adopted this standard in the first quarter of 2018. The adoption did not have an effect on our consolidated financial statements.

In March 2018, the FASB issued ASU 2018-05, which amends ASC Topic 740 “Income Taxes” to conform with SEC Staff Accounting Bulletin 118, issued in December 2017. The guidance was issued to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. The standard is effective upon issuance. Additional work is necessary for a more detailed analysis of our deferred tax assets and liabilities and our historical foreign earnings as well as potential correlative adjustments. We are continuing our analysis and expect to finalize our assessment by the fourth quarter of 2018.

We adjusted our condensed consolidated financial statements from amounts previously reported due to the adoption of ASC 606 and ASU 2016-18. Select unaudited condensed consolidated balance sheet line items, which reflect the adoption of ASC 606 are as follows (in thousands):

	December 31, 2017		
	As Previously Reported	Adjustments	As Adjusted
Assets			
Deferred costs	$—	$ 15,771	$15,771
Deferred costs, noncurrent	—	15,395	15,395
Liabilities and stockholders’ equity			
Deferred revenue	$174,524	$ (1,377)	$173,147
Accumulated deficit	$(430,586)	$ 32,543	$(398,043)

Select unaudited condensed consolidated statement of operations line items, which reflect the adoption of ASC 606 are as follows (in thousands, except per share data):

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	Three Months Ended June 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Revenue	$101,273	$ 823	$102,096
Operating expenses:			
Sales and marketing	52,628	(2,216)	50,412
Operating loss	(30,504)	3,039	(27,465)
Net loss	$(29,306)	$ 3,039	$(26,267)
Net loss per share, basic and diluted	$(0.29)	$ 0.03	$(0.26)

	Six Months Ended June 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Revenue	$194,280	$ 1,704	$195,984
Operating expenses:			
Sales and marketing	99,929	(3,248)	96,681
Operating loss	(57,678)	4,952	(52,726)
Net loss	$(56,300)	$ 4,952	$(51,348)
Net loss per share, basic and diluted	$(0.57)	$ 0.05	$(0.52)

Select unaudited condensed consolidated statement of cash flows line items, which reflect the adoption of ASC 606 and ASU 2016-18 are as follows (in thousands):

	Six Months Ended June 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Cash flow from operating activities			
Net loss	$(56,300)	$ 4,952	$(51,348)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Share-based compensation	40,287	(238)	40,049
Amortization of deferred costs	—	6,598	6,598
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(3,015)	162	(2,853)
Deferred costs	—	(9,609)	(9,609)
Other assets and liabilities	(3,594)	190	(3,404)
Deferred revenue	18,584	(1,703)	16,881
Net cash provided by operating activities	17,225	352	17,577
Net increase in cash, cash equivalents and restricted cash	9,098	352	9,450
Cash, cash equivalents and restricted cash at beginning of period	93,677	1,385	95,062
Cash, cash equivalents and restricted cash at end of period	$102,775	$ 1,737	$104,512

We have also updated our significant accounting policies in connection with the adoption of ASC 606:

Revenue Recognition

We generate substantially all of our revenue from subscription services, which are comprised of subscription fees from customer accounts on Zendesk Support and, to a lesser extent, Chat, Talk, Guide, and Connect. In addition, we generate revenue by providing additional features to certain of our subscription plans for a fee that is incremental to the base subscription rate for such plans. Subscription service arrangements are generally non-cancelable and do not provide for refunds to customers in the event of cancellations or any other right of return. We record revenue net of sales or excise taxes.

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We also derive revenue from implementation, Talk usage, and training services, for which we recognize revenue upon completion.

Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.
We determine revenue recognition through the following steps:
- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, the performance obligation is satisfied

Subscription revenue is recognized on a ratable basis over the contractual subscription term of the arrangement beginning on the date that our service is made available to the customer. Payments received in advance of services being rendered are recorded as deferred revenue.

In limited circumstances, certain customers have arrangements that provide for a maximum number of users over the subscription term, with usage measured monthly. Incremental fees are incurred when the maximum number of users is exceeded. In determining the transaction price for these arrangements, we evaluate the expected usage pattern to estimate any incremental fees that we are entitled to throughout the subscription term and recognize revenue ratably over the subscription term. In making these assessments, we constrain our estimates based on factors that could lead to a probable reversal of revenue.

Certain of our product offerings include service-level agreements warranting defined levels of uptime reliability and performance and permitting those customers to receive credits for future services in the event that we fail to meet those levels. To date, we have not accrued for any significant liabilities in the accompanying consolidated financial statements as a result of these service-level agreements.

Costs to Obtain Customer Contracts

Sales commissions and related expenses are considered incremental and recoverable costs of acquiring customer contracts. These costs are capitalized and amortized on a straight-line basis over the anticipated period of benefit, which we have estimated to be three years. We determined the period of benefit by taking into consideration the length of our customer contracts, our technology lifecycle, and other factors. Amortization expense is recorded in sales and marketing expense within our consolidated statement of operations.

Deferred Revenue

We invoice customers for subscriptions to our products in monthly, quarterly, or annual installments. Deferred revenue consists primarily of customer billings made in advance of performance obligations being satisfied and revenue being recognized, and includes an immaterial amount of billings for subscriptions with cancellation rights. The term between invoicing and when payment is due is not significant and we do not provide financing arrangements to customers. Deferred revenue associated with performance obligations that are anticipated to be satisfied, and thus revenue recognized, during the succeeding 12-month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent deferred revenue. Deferred revenue associated with implementation, Talk usage, and training services was immaterial as of December 31, 2017 and June 30, 2018.

We invoice customers based on billing schedules established in our contracts. Accounts receivable are recorded when the right to consideration becomes unconditional.

Accounts Receivable and Allowance for Doubtful Accounts

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Accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. The allowance is based upon historical loss patterns, the age of each past due invoice, and an evaluation of the potential risk of loss associated with delinquent accounts. Accounts receivable deemed uncollectable are charged against the allowance for doubtful accounts when identified. The balance of accounts receivable also includes contract assets, which are recorded when revenue is recognized in advance of invoicing.

Note 2. Business Combination

On April 27, 2017, we completed the acquisition of Outbound Solutions, Inc., or Outbound, a provider of software that enables companies to deliver intelligent, behavior-based messages across multiple channels. We acquired Outbound for purchase consideration of $16.6 million in cash.

The total purchase consideration was allocated to the assets acquired and liabilities assumed as set forth below (in thousands). The excess of the purchase price over the net assets acquired was recorded as goodwill. Goodwill generated from the acquisition is primarily attributable to expected growth from the expansion of the scope of and market opportunity for our products. Goodwill is not deductible for income tax purposes. Goodwill will not be amortized but instead will be tested for impairment at least annually and more frequently if certain indicators of impairment are present.

Net tangible assets acquired	$96
Net deferred tax liability recognized	(492)
Identifiable intangible assets:	
Developed technology	3,200
Customer relationships	410
Goodwill	13,350
Total purchase price	$16,564

The developed technology and customer relationship intangible assets were assigned useful lives of 6.5 and 3.5 years, respectively.

From the date of the acquisition, the results of operations of Outbound have been included in and are immaterial to our consolidated financial statements. Pro forma revenue and results of operations have not been presented because the historical results of Outbound are not material to our consolidated financial statements in any period presented.

Note 3. Financial Instruments

Investments

The following tables present information about our financial assets measured at fair value on a recurring basis based on the three-tier fair value hierarchy (in thousands):

	Fair Value Measurement at June 30, 2018		
	Level 1	Level 2	Total
Description			
Money market funds	$368,547	$—	$368,547
Corporate bonds	—	248,611	248,611
Asset-backed securities	—	70,016	70,016
Commercial paper	—	69,940	69,940
U.S. treasury securities	—	34,247	34,247
Agency securities	—	26,438	26,438
Total	$368,547	$449,252	$817,799
Included in cash and cash equivalents			$437,526
Included in marketable securities			$380,273

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	Fair Value Measurement at December 31, 2017		
	Level 1	Level 2	Total
Description			
Corporate bonds	$—	$149,069	$149,069
Money market funds	32,832	—	32,832
U.S. treasury securities	—	28,382	28,382
Asset-backed securities	—	27,738	27,738
Commercial paper	—	19,622	19,622
Agency securities	—	14,911	14,911
Total	$32,832	$239,722	$272,554
Included in cash and cash equivalents			$37,531
Included in marketable securities			$235,023

As of June 30, 2018 and December 31, 2017, there were no securities within Level 3 of the fair value hierarchy. There were no transfers between fair value measurement levels during the three and six months ended June 30, 2018. Gross unrealized gains and losses for cash equivalents and marketable securities as of June 30, 2018 and December 31, 2017 were not material. Unrealized losses for securities that have been in an unrealized loss position for more than 12 months as of June 30, 2018 and December 31, 2017 were not material.

The following table classifies our marketable securities by contractual maturity (in thousands):

	June 30, 2018	December 31, 2017
Due in one year or less	$191,503	$137,576
Due after one year	188,770	97,447
Total	$380,273	$235,023

For our other financial instruments, including accounts receivable, accounts payable, and other current liabilities, the carrying amounts approximate their fair values due to the relatively short maturity of these balances.

Derivative Instruments and Hedging

Our foreign currency exposures typically arise from expenditures associated with foreign operations and sales in foreign currencies of our products. To mitigate the effect of foreign currency fluctuations on our future cash flows and earnings, we enter into foreign currency forward contracts with certain financial institutions and designate those contracts as cash flow hedges. Our foreign currency forward contracts generally have maturities of 15 months or less. As of June 30, 2018, the balance of accumulated other comprehensive loss included an unrecognized net loss of $3.0 million related to the effective portion of changes in the fair value of foreign currency forward contracts designated as cash flow hedges. We expect to reclassify a net loss of $3.3 million into earnings over the next 12 months associated with our cash flow hedges.

The following tables present information about our derivative instruments on our consolidated balance sheets (in thousands):

	June 30, 2018			
	Asset Derivatives		Liability Derivatives	
Derivative Instrument	Balance Sheet Location	Fair Value (Level 2)	Balance Sheet Location	Fair Value (Level 2)
Foreign currency forward contracts	Other current assets	$1,791	Accrued liabilities	$4,460

Total	$1,791	$4,460

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	December 31, 2017			
	Asset Derivatives		Liability Derivatives	
Derivative Instrument	Balance Sheet Location	Fair Value (Level 2)	Balance Sheet Location	Fair Value (Level 2)
Foreign currency forward contracts	Other current assets	$2,359	Accrued liabilities	$1,220
Total		$2,359		$1,220

Our foreign currency forward contracts had a total notional value of $170.4 million and $139.7 million as of June 30, 2018 and December 31, 2017, respectively. We have master netting arrangements with each of our counterparties, which permit net settlement of multiple, separate derivative contracts with a single payment. We may also be required to exchange cash collateral with certain of our counterparties on a regular basis. ASC 815 permits companies to present the fair value of derivative instruments on a net basis according to master netting arrangements. We have elected to present our derivative instruments on a gross basis in our consolidated financial statements. As of June 30, 2018 and December 31, 2017, there was no cash collateral posted with counterparties.

The following table presents information about our derivative instruments on our condensed consolidated statements of operations (in thousands):

		Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
Hedging Instrument	Location of Gain Reclassified into Earnings	Loss Recognized in AOCI	Gain Reclassified from AOCI into Earnings	Loss Recognized in AOCI	Gain Reclassified from AOCI into Earnings
Foreign currency forward contracts	Revenue, cost of revenue, operating expenses	$(3,118)	$ 14	$(2,799)	$ 1,075
Total		$(3,118)	$ 14	$(2,799)	$ 1,075

		Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
Hedging Instrument	Location of Loss Reclassified into Earnings	Gain Recognized in AOCI	Loss Reclassified from AOCI into Earnings	Gain Recognized in AOCI	Loss Reclassified from AOCI into Earnings
Foreign currency forward contracts	Revenue, cost of revenue, operating expenses	$1,495	$ (327)	$2,488	$ (860)
Total		$—	$ —	$2,488	$ (860)

All derivatives have been designated as hedging instruments. Amounts recognized in earnings related to excluded time value and hedge ineffectiveness for the three and six months ended June 30, 2018 and 2017 were not material.

Convertible Senior Notes

As of June 30, 2018, the fair value of our convertible senior notes was $618.6 million. The fair value was determined based on the quoted price of the convertible senior notes in an inactive market on the last trading day of the reporting period and has been classified as Level 2 in the fair value hierarchy.

Note 4. Costs to Obtain Customer Contracts

The balances of deferred costs to obtain customer contracts were $39.6 million and $31.2 million as of June 30, 2018 and December 31, 2017, respectively. Amortization expense for these deferred costs was $5.0 million and $3.4 million for the
three months ended June 30, 2018 and 2017, respectively, and $9.5 million and $6.6 million for the six months ended June 30, 2018 and 2017, respectively. There were no impairment losses related to these deferred costs for the periods presented.

Note 5. Property and Equipment

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

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	June 30, 2018	December 31, 2017
Leasehold improvements	$42,330	$28,113
Capitalized internal-use software	37,028	31,593
Hosting equipment	36,416	37,222
Computer equipment and licensed software and patents	19,932	16,316
Construction in progress	12,520	11,220
Furniture and fixtures	10,506	9,581
Total	158,732	134,045
Less: accumulated depreciation and amortization	(89,306)	(74,888)
Property and equipment, net	$69,426	$59,157

Depreciation expense was $6.5 million and $5.1 million for the three months ended June 30, 2018 and 2017, respectively, and $12.8 million and $9.8 million for the six months ended June 30, 2018 and 2017, respectively. Amortization expense of capitalized internal-use software was $1.4 million and $2.1 million for the three months ended June 30, 2018 and 2017, respectively, and $3.0 million and $4.2 million for the six months ended June 30, 2018 and 2017, respectively. We recorded impairment losses of $0.2 million and $2.0 million to construction in progress during the three and six months ended June 30, 2018, which were included within research and development expenses on our consolidated statements of operations. The carrying value of capitalized internal-use software at June 30, 2018 and December 31, 2017 was $18.4 million and $17.7 million, respectively, including $7.0 million and $8.7 million in construction in progress, respectively.

Note 6. Goodwill and Acquired Intangible Assets

The balance of goodwill as of June 30, 2018 was $59.1 million and there were no changes in the carrying amount of goodwill for the six months ended June 30, 2018.

Acquired intangible assets subject to amortization consist of the following (in thousands):

	As of June 30, 2018			
	Cost	Accumulated Amortization	Net	Weighted Average Remaining Useful Life
				(In years)
Developed technology	$12,000	$ (5,951)	$6,049	3.3
Customer relationships	910	(443)	467	2.1
	$12,910	$ (6,394)	$6,516	

	As of December 31, 2017				
	Cost	Accumulated Amortization	Foreign Currency Translation Adjustments	Net	Weighted Average Remaining Useful Life
					(In years)
Developed technology	$17,200	$ (9,835)	$ (93)	$7,272	3.7
Customer relationships	2,210	(1,549)	(30)	631	2.4
	$19,410	$ (11,384)	$ (123)	$7,903	

During the second quarter of 2018, we removed developed technology and customer relationship intangible assets from our consolidated balance sheet, which had become fully amortized. Amortization expense of acquired intangible assets was $0.7 million and $1.0 million for the three months ended June 30, 2018 and 2017, respectively, and $1.4

million and $2.0 million for the six months ended June 30, 2018 and 2017, respectively.
Estimated future amortization expense as of June 30, 2018 is as follows (in thousands):

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Remainder of 2018	$1,348
2019	2,673
2020	1,101
2021	492
2022	492
2023	410
	$6,516

Note 7. 0.25% Convertible Senior Notes and Capped Call

In March 2018, we issued $500.0 million aggregate principal amount of 0.25% convertible senior notes due March 15, 2023 in a private offering and an additional $75.0 million aggregate principal amount of such notes pursuant to the exercise in full of the over-allotment options of the initial purchasers, collectively the "Notes." The Notes are unsecured obligations and bear interest at a fixed rate of 0.25% per annum, payable semi-annually in arrears on March 15 and September 15 of each year, commencing on September 15, 2018. The total net proceeds from the offering, after deducting initial purchase discounts and estimated debt issuance costs, are approximately $561.4 million.

Each $1,000 principal amount of the Notes will initially be convertible into 15.8554 shares of our common stock, the "Conversion Option," which is equivalent to an initial conversion price of approximately $63.07 per share, subject to adjustment upon the occurrence of specified events. The Notes will be convertible at the option of the holders at any time prior to the close of business on the business day immediately preceding December 15, 2022, only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending on June 30, 2018 (and only during such calendar quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period, the "Measurement Period," in which the trading price per $1,000 principal amount of notes for each trading day of the Measurement Period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events (as set forth in the indenture). On or after December 15, 2022 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their Notes at any time, regardless of the foregoing circumstances. Upon conversion, we will pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election. If certain specified fundamental changes occur (as set forth in the indenture) prior to the maturity date, holders of the Notes may require us to repurchase for cash all or any portion of their notes at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date. In addition, if specific corporate events occur prior to the applicable maturity date, we will increase the conversion rate for a holder who elects to convert their notes in connection with such a corporate event in certain circumstances. It is our current intent and policy to settle conversions through combination settlement with a specified dollar amount of $1,000 per $1,000 principal amount of Notes. During the three and six months ended June 30, 2018, the conditions allowing holders of the Notes to convert have not been met. The Notes are therefore not convertible during the three and six months ended June 30, 2018 and are classified as long-term debt.

In accounting for the transaction, the Notes were separated into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated convertible feature. The carrying amount of the equity component representing the Conversion Option was $125.0 million and was determined by deducting the fair value of the liability component from the par value of the Notes. The equity component was recorded in additional paid-in capital and is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the liability component over its carrying amount, the "Debt Discount," is amortized to interest expense over the contractual term of the Notes at an effective interest rate of 5.26%.

In accounting for the debt issuance costs of $13.6 million related to the Notes, we allocated the total amount incurred to the liability and equity components of the Notes based on their relative values. Issuance costs attributable to the liability component were $10.6 million and will be amortized to interest expense using the effective interest method over the contractual term of the Notes. Issuance costs attributable to the equity component were netted with the equity component in additional paid-in capital.

The net carrying amount of the liability component of the Notes is as follows (in thousands):

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	June 30, 2018	December 31, 2017
Principal	$575,000	$ —
Unamortized Debt Discount	(118,774)	—
Unamortized issuance costs	(10,166)	—
Net carrying amount	$446,060	$ —

The net carrying amount of the equity component of the Notes is as follows (in thousands):

	June 30, 2018	December 31, 2017
Debt Discount for Conversion Option	$124,976	$ —
Issuance costs	(2,948)	—
Net carrying amount	$122,028	$ —

Interest expense related to the Notes is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Contractual interest expense	$359	$ —	$403	$ —
Amortization of Debt Discount	5,531	—	6,202	—
Amortization of issuance costs	399	—	448	—
Total interest expense	$6,289	$ —	$7,053	$ —

In connection with the pricing of the Notes, we entered into privately negotiated capped call transactions with certain counterparties, the "Capped Calls." The Capped Calls each have an initial strike price of approximately $63.07 per share, subject to certain adjustments, which correspond to the initial conversion price of the Notes. The Capped Calls have initial cap prices of $95.20 per share, subject to certain adjustments. The Capped Calls cover, subject to anti-dilution adjustments, approximately 9.1 million shares of our common stock. Conditions that cause adjustments to the initial strike price of the Capped Calls mirror conditions that result in corresponding adjustments for the Notes. The Capped Calls are generally intended to reduce or offset the potential dilution to our common stock upon any conversion of the Notes with such reduction or offset, as the case may be, subject to a cap based on the cap price. For accounting purposes, the Capped Calls are separate transactions, and not part of the terms of the Notes. As these transactions meet certain accounting criteria, the Capped Calls are recorded in stockholders' equity and are not accounted for as derivatives. The cost of $63.9 million incurred in connection with the Capped Calls was recorded as a reduction to additional paid-in capital.

The difference between the Debt Discount and the total cost of the Capped Call, and the difference between the calculation of the book and tax allocation of debt issuance costs between the liability and equity components of the Notes, resulted in a difference between the carrying amount and tax basis of the Notes. This taxable temporary difference resulted in the recognition of a $13.8 million net deferred tax liability which was recorded as an adjustment to additional paid-in capital. The creation of the deferred tax liability represents a source of future taxable income which supports realization of a portion of the income tax benefit associated with our loss from operations. Therefore, applying the guidance in ASC 740 to interim reporting periods, we recorded a net income tax benefit of $1.4 million in our consolidated statement of operations and an income tax benefit of $1.1 million in our consolidated statement of comprehensive loss for the three months ended June 30, 2018. This represents applying an estimated effective tax rate resulting from the recognition of the deferred tax asset to the pre-tax loss for the quarter.

The net impact to our stockholders' equity, included in additional paid-in capital, of the above components of the Notes is as follows (in thousands):

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Conversion Option	$124,976
Purchase of Capped Calls	(63,940)
Issuance costs	(2,948)
Net deferred tax liability	(13,784)
Total	$44,304

Note 8. Commitments and Contingencies

Contractual Obligations

We lease office space under noncancelable operating leases with various expiration dates. Certain of the office space lease agreements contain rent holidays or rent escalation provisions. Rent holiday and rent escalation provisions are considered in determining the straight-line expense to be recorded over the lease term. The lease term begins on the date of initial possession of the leased property for purposes of recognizing lease expense on a straight-line basis over the term of the lease. Rent expense was $4.4 million and $2.8 million for the three months ended June 30, 2018 and 2017, respectively, and $8.8 million and $5.5 million for the six months ended June 30, 2018 and 2017, respectively.

There were no material changes in our commitments under contractual obligations, as disclosed in our audited consolidated financial statements for the year ended December 31, 2017.

Litigation and Loss Contingencies

We accrue estimates for resolution of legal and other contingencies when losses are probable and estimable. From time to time, we may become a party to litigation and subject to claims that arise in the ordinary course of business, including intellectual property claims, labor and employment claims, threatened claims, breach of contract claims, tax, and other matters. We currently have no material pending litigation.

We are not currently aware of any litigation matters or loss contingencies that would be expected to have a material adverse effect on our business, consolidated balance sheets, results of operations, comprehensive loss, or cash flows.

Indemnifications

In the ordinary course of business, we enter into contractual arrangements under which we agree to provide indemnification of varying scope and terms to customers, business partners, and other parties with respect to certain matters, including, but not limited to, losses arising out of the breach of such agreements, intellectual property infringement claims made by third parties, and other liabilities relating to or arising from our products or our acts or omissions. In these circumstances, payment may be conditional on the other party making a claim pursuant to the procedures specified in the particular contract. Further, our obligations under these agreements may be limited in terms of time and/or amount, and in some instances, we may have recourse against third parties for certain payments. In addition, we have indemnification agreements with our directors and executive officers that require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. The terms of such obligations may vary. To date, we have not incurred any material costs, and we have not accrued any liabilities in our consolidated financial statements, as a result of these obligations.

Certain of our product offerings include service-level agreements warranting defined levels of uptime reliability and performance, which permit those customers to receive credits for future services in the event that we fail to meet those levels. To date, we have not accrued for any significant liabilities in our consolidated financial statements as a result of these service-level agreements.

Note 9. Common Stock and Stockholders’ Equity

Common Stock

As of June 30, 2018 and December 31, 2017, there were 400 million shares of common stock authorized for issuance with a par value of $0.01 per share and 105.7 million and 103.1 million shares were issued and outstanding, respectively.

Preferred Stock

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As of each of June 30, 2018 and December 31, 2017, there were 10 million shares of preferred stock authorized for issuance with a par value of $0.01 per share and no shares of preferred stock were issued or outstanding.

Employee Equity Plans

Employee Stock Purchase Plan

Under our Employee Stock Purchase Plan, or ESPP, eligible employees are granted options to purchase shares of our common stock through payroll deductions. The ESPP provides for 18-month offering periods, which include three six-month purchase periods. At the end of each purchase period, employees are able to purchase shares at 85% of the lower of the fair market value of our common stock at the beginning of an offering period or the fair market value of our common stock at the end of the purchase period. For both the three and six months ended June 30, 2018, 0.4 million shares of common stock were purchased under the ESPP. Pursuant to the terms of the ESPP, the number of shares reserved under the ESPP increased by 1.0 million shares on January 1, 2018. As of June 30, 2018, 4.2 million shares of common stock were available for issuance under the ESPP.

Stock Option and Grant Plans

Our board of directors adopted the 2009 Stock Option and Grant Plan, or the 2009 Plan, in July 2009. The 2009 Plan was terminated in connection with our initial public offering in May 2014, and accordingly, no shares are available for issuance under this plan. The 2009 Plan continues to govern outstanding awards granted thereunder.

Our 2014 Stock Option and Incentive Plan, or the 2014 Plan, serves as the successor to our 2009 Plan. Pursuant to the terms of the 2014 Plan, the number of shares reserved for issuance under the 2014 Plan increased by 5.2 million shares on January 1, 2018. As of June 30, 2018, we had 9.3 million shares of common stock available for future grants under the 2014 Plan.

On May 6, 2016, the compensation committee of our board of directors granted equity awards representing 1.2 million shares. These awards were granted outside of the 2014 Plan pursuant to an exemption provided for “employment inducement awards” within the meaning of Section 303A.08 of the New York Stock Exchange Listed Company Manual and accordingly did not require approval from our stockholders.

A summary of our stock option and restricted stock unit, or RSU, activity for the six months ended June 30, 2018 is as follows (in thousands, except per share information):

	Options Outstanding					RSUs Outstanding	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value	Outstanding RSUs	Weighted Average Grant Date Fair Value
				(In years)			
Outstanding — January 1, 2018	8,001	6,239	$ 17.31	7.11	$ 103,380	5,827	$ 25.00
Increase in authorized shares	5,156						
Stock options granted	(756)	756	42.08				
RSUs granted	(3,643)					3,643	39.43
Stock options exercised		(674)	14.46				
RSUs vested						(1,498)	25.69
Stock options forfeited or canceled	68	(68)	28.61				
RSUs forfeited or canceled	487					(487)	28.43
RSUs forfeited or canceled and unavailable for grant						(13)	23.44
Outstanding — June 30, 2018	9,313	6,253	$ 20.49	7.05	$ 212,871	7,472	$ 31.68

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The RSUs forfeited or canceled and unavailable for grant relate to our employment inducement awards. The aggregate intrinsic value for options outstanding represents the difference between the closing market price of our common stock and the exercise price of outstanding, in-the-money options.

As of June 30, 2018, we had a total of $262.1 million in future share-based compensation expense related to all equity awards to be recognized over a weighted average period of 2.9 years.

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Note 10. Deferred Revenue and Performance Obligations

During the three months ended June 30, 2018 and 2017, $93.4 million and $69.3 million of revenue was recognized that was included in the deferred revenue balances at the beginning of each period, respectively. During the six months ended June 30, 2018 and 2017, $139.3 million and $102.7 million of revenue was recognized that was included in the deferred revenue balances at the beginning of each period, respectively.

The aggregate balance of unsatisfied performance obligations as of June 30, 2018 was $326.2 million. We expect to recognize $265.9 million of the balance as revenue in the next 12 months and the remainder thereafter. The aggregate balance of unsatisfied performance obligations represents contracted revenue that has not yet been recognized and does not include contract amounts which are cancelable by the customer and amounts associated with optional renewal periods.

Note 11. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including those related to outstanding share-based awards and our convertible senior notes, to the extent dilutive. Basic and diluted net loss per share were the same for each period presented as the inclusion of all potential common stock outstanding would have been anti-dilutive.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017 * As adjusted	2018	2017 * As adjusted
Net loss	$(34,366)	$(26,267)	$(63,691)	$(51,348)
Weighted-average shares used to compute basic and diluted net loss per share	105,000	99,506	104,350	98,545
Net loss per share, basic and diluted	$(0.33)	$(0.26)	$(0.61)	$(0.52)

*Adjusted to reflect the adoption of ASC 606 (see Note 1).

The anti-dilutive securities related to share-based compensation excluded from the shares used to calculate diluted net loss per share are as follows (in thousands):

	As of June 30,	
	2018	2017
Shares subject to outstanding common stock options and employee stock purchase plan	6,358	7,448
Restricted stock units	7,472	6,801
	13,830	14,249

Additionally, the 9.1 million shares underlying the conversion option in the convertible senior notes are not considered in the calculation of diluted net loss per share as the effect would be anti-dilutive. Additionally, the convertible senior notes are not convertible as of June 30, 2018. We expect to settle the principal amount of the convertible senior notes in cash and therefore use the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread will have a dilutive impact on diluted net income per share when the average market price of our common stock for a given period exceeds the initial conversion price of $63.07 per share for the convertible senior notes. During the three and six months ended June 30, 2018, the average market price of our common stock did not exceed the conversion price.

Note 12. Income Taxes

We reported a benefit from income taxes of $1.7 million and $5.0 million in the three and six months ended June 30, 2018, respectively, primarily due to the recognition of a net income tax benefit of $1.4 million related to taxable temporary differences of the convertible senior notes and the capped call. We reported a benefit from income taxes of $0.7 million for each of the three and six months ended June 30, 2017. The effective tax rate for each period differs from the statutory ra

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te primarily as a result of not recognizing a deferred tax asset for U.S. losses due to having a full valuation allowance against U.S. deferred tax assets.

Note 13. Geographic Information

Our chief operating decision maker reviews the financial information presented on a consolidated basis for purposes of allocating resources and evaluating our financial performance. Accordingly, we have determined that we operate in a single reporting segment.

Revenue

The following table presents our revenue by geographic area, as determined based on the billing address of our customers (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017 *As adjusted	2018	2017 * As adjusted
United States	$73,019	$54,733	$141,373	$105,432
EMEA	41,765	29,057	79,637	55,346
APAC	16,111	10,874	30,107	20,745
Other	10,987	7,432	20,556	14,461
Total	$141,882	$102,096	$271,673	$195,984

*Adjusted to reflect the adoption of ASC 606 (see Note 1).

Long-Lived Assets

The following table presents our long-lived assets by geographic area (in thousands):

	As of June 30, 2018	As of December 31, 2017
United States	$23,006	$ 23,609
EMEA:		
Republic of Ireland	16,449	5,019
Other EMEA	3,328	5,007
Total EMEA	19,777	10,026
APAC	8,137	7,734
Total	$50,920	$ 41,369

The carrying values of capitalized internal-use software and intangible assets are excluded from the balance of long-lived assets presented in the table above.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 22, 2018. As discussed in the section titled "Special Note Regarding Forward-Looking Statements," the following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included under Part II, Item 1A below.

Overview

We are a software development company that provides SaaS products that are intended to help organizations and their customers build better relationships. Our product family is built upon a modern architecture that enables us and our customers to rapidly innovate, adapt our technology in novel ways, and easily integrate with other products and applications. With our origins in customer service, we have evolved our offerings over time to a family of products that work together to help organizations understand their customers, improve communications across all channels, and engage where and when it's needed most.

We believe in developing products that serve organizations of all sizes and across all industries. The flagship product in our family, Zendesk Support, provides organizations with the ability to track, prioritize, and solve customer support tickets across multiple channels, bringing customer information and interactions into one place. Our other widely available products integrate with Support and include Zendesk Chat, Zendesk Talk, Zendesk Guide, and Zendesk Connect. Chat is live chat software that provides a fast and responsive way for organizations to connect with their customers. Talk is cloud-based call center software that facilitates personal and productive phone support conversations between organizations and their customers. Guide is a self-service destination that organizations can use to provide articles, interactive forums, and a community that help an organization's customers help themselves. Connect enables customer service teams to send automated and timely messages based on a customer's past actions and preferences. Additionally, we offer Zendesk Suite, an omnichannel offering which provides Support, Chat, Talk, and Guide together for a single price. We offer a range of subscription account plans for our products that vary in price based on functionality, type, and the amount of product support we offer. We also offer a range of additional features that customers can purchase and add to their subscriptions.

For the three months ended June 30, 2018 and 2017, our revenue was $141.9 million and $102.1 million, respectively, representing a 39% growth rate. For the six months ended June 30, 2018 and 2017, our revenue was $271.7 million and $196.0 million, respectively, representing a 39% growth rate. For the three months ended June 30, 2018 and 2017, we derived $68.9 million, or 49%, and $47.4 million, or 46%, respectively, of our revenue from customers located outside of the United States. For the six months ended June 30, 2018 and 2017, we derived $130.3 million, or 48%, and $90.6 million, or 46%, respectively, of our revenue from customers located outside of the United States. We expect that the rate of growth in our revenue will decline as our business scales, even if our revenue continues to grow in absolute terms. For the three months ended June 30, 2018 and 2017, we generated net losses of $34.4 million and $26.3 million, respectively. For the six months ended June 30, 2018 and 2017, we generated net losses of $63.7 million and $51.3 million, respectively.

The growth of our business and our future success depend on many factors, including our ability to continue to innovate, further develop our unified omnichannel offering, build brand recognition and a scalable product for larger enterprises, maintain our leadership in the small and medium-sized business market, add new customers, generate additional revenue from our existing customer base, and increase our global customer footprint. While these areas represent significant opportunities for us, we also face significant risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results. We anticipate that we will continue to expand our operations and headcount in the near term. The expected expenditures that we anticipate will be necessary to manage our anticipated growth, including personnel costs, expenditures relating to hosting capabilities, leasehold improvements, and related fixed assets, will make it more difficult for us to achieve

profitability in the near term. Many of these investments will occur in advance of us experiencing any direct benefit and will make it difficult to determine if we are allocating our resources efficiently.
We have focused on rapidly growing our business and plan to continue to invest for long-term growth. We expect to continue to develop our hosting capabilities primarily through expenditures for third-party managed hosting services. Additionally, we expect to incur depreciation expense and related costs associated with our self-managed colocation data centers while we transition our primary data center usage to third-party managed hosting services. The amount and timing of these disbursements will vary based on our estimates of projected growth and planned use of hosting resources. Over time, we

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anticipate that we will continue to gain economies of scale by efficiently utilizing our hosting and personnel resources to support the growth in our number of customers. We also expect to continue to grow our customer experience organization, resulting in additional salary and share-based compensation expenses. In addition, we expect to incur amortization expense associated with acquired intangible assets and capitalized internal-use software. As a result, we expect our gross margin to improve in the long-term, although our gross margin may decrease in the near-term and may vary from period to period as our revenue fluctuates and as a result of the timing and amount of such costs.

We expect our operating expenses to continue to increase in absolute dollars in future periods. We have invested, and expect to continue to invest, in our software development efforts to broaden the functionality of our existing products, to further integrate these products and services, and to introduce new products. We plan to continue to expand our sales and marketing organizations, particularly in connection with our efforts to expand our customer base. We also expect to continue to incur additional general and administrative costs in order to support the growth of our business and the infrastructure required to comply with our obligations as a public company.

Key Business Metrics

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

Number of Paid Customer Accounts. We believe that our ability to increase our number of paid accounts using our products is an indicator of our market penetration, the growth of our business, and our potential future business opportunities. We define the number of paid customer accounts as the sum of the number of accounts on Zendesk Support, exclusive of our legacy Starter plan, free trials, or other free services, the number of accounts on Chat, exclusive of free trials or other free services, and the number of accounts on all of our other products, exclusive of free trials and other free services, each as of the end of the period and as identified by a unique account identifier. In the quarter ended June 30, 2018, we began to offer an omnichannel subscription, which provides access to multiple products through a single paid customer account, Zendesk Suite. The number of Suite paid customer accounts are included in the number of accounts on products other than Support and Chat, and are not included in the number of paid customer accounts using Support or Chat. Other than usage of our products through our omnichannel subscription offering, the use of Support, Chat, and our other products requires separate subscriptions and each of these accounts are treated as a separate paid customer account. Existing customers may also expand their utilization of our products by adding new accounts and a single consolidated organization or customer may have multiple accounts across each of our products to service separate subsidiaries, divisions, or work processes. Other than usage of our products through our omnichannel subscription offering, each of these accounts is also treated as a separate paid customer account. Other than paid accounts for Zendesk Connect, an increase in the number of paid customer accounts generally correlates to an increase in the number of authorized agents licensed to use our products, which directly affects our revenue and results of operations. We view growth in this metric as a measure of our success in converting new sales opportunities. We had approximately 130,300 paid customer accounts as of June 30, 2018, including approximately 70,500 paid customer accounts on Support, approximately 47,600 paid customer accounts on Chat, and approximately 12,200 paid customer accounts on our other products. As the total number of paid customer accounts increases, we expect the rate of growth in the number of paid customer accounts to decline.

Dollar-Based Net Expansion Rate. Our ability to generate revenue is dependent upon our ability to maintain our relationships with our customers and to increase their utilization of our products. We believe we can achieve this by focusing on delivering value and functionality that retains our existing customers, expands the number of authorized agents associated with an existing paid customer account, and results in upgrades to higher-priced subscription plans and the purchase of additional products. Maintaining customer relationships allows us to sustain and increase revenue to the extent customers maintain or increase the number of authorized agents licensed to use our products. We assess our performance in this area by measuring our dollar-based net expansion rate. Our dollar-based net expansion rate provides a measurement of our ability to increase revenue across our existing customer base through expansion of authorized agents associated with paid customer accounts, upgrades in subscription plans, and the purchase of additional products as offset by churn, contraction in authorized agents associated with paid customer accounts, and downgrades in subscription plans. We do not currently incorporate operating metrics associated with our analytics product or our Connect product into our measurement of dollar-based net expansion rate.

Our dollar-based net expansion rate is based upon our monthly recurring revenue for a set of paid customer accounts on our products. Monthly recurring revenue for a paid customer account is a legal and contractual determination made by assessing the contractual terms of each paid customer account, as of the date of determination, as to the revenue we expect to generate in the next monthly period for that paid customer account, assuming no changes to the subscription and without taking into account any one-time discounts or any usage above the subscription base, if any, that may be applicable to such subscription. Monthly recurring revenue is not determined by reference to historical revenue, deferred revenue, or any other United States generally accepted accounting principles, or GAAP, financial measure over any period. It is forward-looking and contractually derived as of the date of determination.

We calculate our dollar-based net expansion rate by dividing our retained revenue net of contraction and churn by our base revenue. We define our base revenue as the aggregate monthly recurring revenue across our products from the paid customer accounts on Support and Chat as of the date one year prior to the date of calculation. We define our retained revenue net of contraction and churn as the aggregate monthly recurring revenue across our products from the same customer base included in our measure of base revenue at the end of the annual period being measured. Our dollar-based net expansion rate is also adjusted to eliminate the effect of certain activities that we identify involving the transfer of agents between paid customer accounts, consolidation of customer accounts, or the split of a single paid customer account into multiple paid customer accounts. In addition, our dollar-based net expansion rate is adjusted to include paid customer accounts in the customer base used to determine retained revenue net of contraction and churn that share common corporate information with customers in the customer base that is used to determine our base revenue. Giving effect to this consolidation results in our dollar-based net expansion rate being calculated across approximately 107,800 customers, as compared to the approximately 130,300 total paid customer accounts as of June 30, 2018. To the extent that we can determine that the underlying customers do not share common corporate information, we do not aggregate paid customer accounts associated with reseller and other similar channel arrangements for the purposes of determining our dollar-based net expansion rate. While not material, we believe the failure to account for these activities would otherwise skew our dollar-based net expansion metrics associated with customers that maintain multiple paid customer accounts across their products, and paid customer accounts associated with reseller and other similar channel arrangements.

Our dollar-based net expansion rate was 119% as of June 30, 2018. We expect that, among other factors, our continued focus on adding larger paid customer accounts at the time of addition and the growth in our revenue will result in an overall decline in our dollar-based net expansion rate over time as our aggregate monthly recurring revenue grows.

Components of Results of Operations

Revenue

We derive substantially all of our revenue from subscription services, which are comprised of subscription fees from customer accounts on Support and, to a lesser extent, Chat, Talk, Guide, and Connect. Each subscription may have multiple authorized users, and we refer to each user as an “agent.” The number of agents ranges from one to thousands for various customer accounts. Our pricing is generally established on a per agent basis. We offer a range of subscription account plans for our products that vary in price based on functionality, type, and, for Support and Chat, the amount of product support we offer. We also offer a range of additional features that customers can purchase and add to their subscriptions. Certain arrangements provide for incremental fees above a fixed maximum number of monthly agents during the subscription term. We sell subscription services under contractual agreements that vary in length, ranging between one month and multiple years, with the majority of subscriptions having a term of either one month or one year.

Subscription fees are generally non-refundable regardless of the actual use of the service. Subscription revenue is typically affected by the number of customer accounts, number of agents, and the type of plan purchased by our customers, and is recognized ratably over the term of the arrangement beginning on the date that our services are made available to our customers. Subscription services purchased online are typically paid for via a credit card on the date of purchase while subscription services purchased through our internal sales organization are generally billed with monthly, quarterly, or annual payment frequencies. Due to our mixed contract lengths and billing frequencies, the annualized value of the arrangements we enter into with our customers may not be fully reflected in deferred revenue at any single point in time. Accordingly, we do not believe that the change in deferred revenue for any period is an accurate indicator of future revenue for a given period of time. Additionally, because of the mix of contract lengths, customer purchasing patterns, and renewal patterns for our products, we do not believe that the amount of unsatisfied performance obligations, or any backlog calculated therefrom, measured as of any particular determination date, or period-over-period changes in such amounts, are accurate predictors of our future revenue for any future period, and we caution you not to rely on such amounts for that purpose.

We also derive revenue from implementation, Talk usage, and training services, for which we recognize revenue upon completion.

Cost of Revenue, Gross Margin, and Operating Expenses

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Cost of Revenue. Cost of revenue consists primarily of personnel costs (including salaries, share-based compensation, and benefits) for employees associated with our infrastructure, product support, and professional service organizations, and expenses for hosting capabilities, including third-party managed hosting services and depreciation from our self-managed colocation data centers. Cost of revenue also includes third-party license fees, payment processing fees, amortization expense associated with capitalized internal-use software, amortization expense associated with acquired intangible assets, and allocated shared costs. We allocate shared costs such as facilities, information technology, and security costs to all departments based on headcount. As such, allocated shared costs are reflected in cost of revenue and each operating expense category.

We currently operate out of four self-managed colocation data centers, in which we manage our own network equipment and systems, located in California, Virginia, Ireland, and Germany. In addition, we utilize third-party managed hosting facilities located in North America, Europe, Asia, and Australia to host our services, support our infrastructure, and support certain research and development functions. We currently intend to continue to operate our self-managed colocation data centers and incur expenditures for third-party managed hosting services over time while we transition our primary data center usage to third-party managed hosting services.

We intend to continue to invest additional resources in our infrastructure, product support, and professional service organizations, organically and through acquisitions. We expect that recent and future business acquisitions will result in increased amortization expense of intangible assets such as acquired technology. As we continue to invest in technology innovation, we expect to continue to incur capitalized internal-use software costs and related amortization. We expect these investments in technology to not only expand the capabilities of our products but also to increase the efficiency of how we deliver these services, enabling us to improve our gross margin over time, although our gross margin may decrease in the near-term and may vary from period to period as our revenue fluctuates and as a result of the timing and amount of these investments. To the extent that we continue to rely on third-party technology to provide certain functionality within our products or for certain subscription plans or integrations, we expect third-party license fees for technology that is incorporated in such products and subscription plans to remain significant over time.

Gross Margin. Gross margin is gross profit expressed as a percentage of revenue. Our gross margin may fluctuate from period to period as our revenue fluctuates and as a result of the timing and amount of investments to expand our product support and professional services teams, investments in additional personnel, hosting equipment, and third-party managed hosting facilities to support our infrastructure, increased share-based compensation expense, as well as the amortization of certain acquired intangible assets, costs associated with capitalized internal-use software, and third-party license fees.

Research and Development. Research and development expenses consist primarily of personnel costs (including salaries, share-based compensation, and benefits) for employees associated with our research and development organization and allocated shared costs.

We focus our research and development efforts on the continued development of our products, including the development and deployment of new features and functionality and enhancements to our software architecture and integration across our products. We expect that, in the future, research and development expenses will increase in absolute dollars. However, we expect our research and development expenses to decrease modestly as a percentage of our revenue in the long-term, although this may fluctuate from period to period depending on fluctuations in revenue and the timing and the extent of our research and development expenses.

Sales and Marketing. Sales and marketing expenses consist of personnel costs (including salaries, share-based compensation, sales commissions, and benefits) for employees associated with our sales and marketing organizations, costs of marketing activities, and allocated shared costs. Marketing activities include online lead generation, advertising, promotional events, and public and community relations. Sales commissions are considered incremental costs of obtaining customer contracts and are capitalized and amortized on a straight-line basis over the anticipated period of benefit, which we have determined to be three years.

We focus our sales and marketing efforts on generating awareness of our products, establishing and promoting our brand, and cultivating a community of successful and vocal customers. We plan to continue investing in sales and marketing by increasing the number of sales employees, developing our marketing teams, building brand awareness, and sponsoring additional marketing events, which we believe will enable us to add new customers and increase penetration within our existing customer base. Because we do not have a long history of undertaking or growing many of these activities, we cannot predict whether, or to what extent, our revenue will increase as we invest in these strategies. We expect our sales and marketing expenses to continue to increase in absolute dollars and continue to be our largest operating expense category for the foreseeable future. Our sales and marketing expenses as a percentage of our revenue over time may fluctuate from period to period depending on fluctuations in revenue and the timing and extent of our sales and marketing expenses.

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General and Administrative. General and administrative expenses consist primarily of personnel costs (including salaries, share-based compensation, and benefits) for our executive, finance, legal, human resources, and other administrative employees. In addition, general and administrative expenses include fees for third-party professional services, including legal, accounting, and tax related services, other corporate expenses, and allocated shared costs. We expect to incur incremental costs associated with supporting the growth of our business, both in terms of size and geographic expansion, and the infrastructure required to be a public company. Such costs include increases in our finance, legal, and human resources personnel, additional legal, accounting, tax, and compliance-related services fees, insurance costs, and costs of executing significant transactions, including business acquisitions, and other costs associated with being a public company. As a result, we expect our general and administrative expenses to continue to increase in absolute dollars for the foreseeable future. However, we expect our general and administrative expenses to decrease modestly as a percentage of our revenue in the long-term, although this may fluctuate from period to period depending on fluctuations in revenue and the timing and extent of our general and administrative expenses.

Other Income (Expense), Net

Other income (expense), net consists primarily of interest income from marketable securities, foreign currency gains and losses, and interest expense from our convertible senior notes. Interest expense includes amortization of the debt discount, amortization of issuance costs, and contractual interest expense.

Provision for (Benefit from) Income Taxes

Provision for (benefit from) income taxes consists of federal and state income taxes in the United States and income taxes in certain foreign jurisdictions.

Results of Operations

The following tables set forth our results of operations for the periods presented in dollars and as a percentage of our revenue:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017 * As adjusted	2018	2017 * As adjusted
Revenue	$141,882	$102,096	$271,673	$195,984
Cost of revenue (1)	44,160	30,663	83,216	58,770
Gross profit	97,722	71,433	188,457	137,214
Operating expenses (1):				
Research and development	37,624	28,698	74,708	55,154
Sales and marketing	69,450	50,412	134,508	96,681
General and administrative	24,245	19,788	46,452	38,105
Total operating expenses	131,319	98,898	255,668	189,940
Operating loss	(33,597)	(27,465)	(67,211)	(52,726)
Other income (expense), net				
Interest income	3,826	827	5,344	1,540
Interest expense	(6,289)	—	(7,053)	—
Other income (expense), net	27	(319)	272	(814)
Total other income (expense), net	(2,436)	508	(1,437)	726
Loss before benefit from income taxes	(36,033)	(26,957)	(68,648)	(52,000)
Benefit from income taxes	(1,667)	(690)	(4,957)	(652)
Net loss	$(34,366)	$(26,267)	$(63,691)	$(51,348)

(1) Includes share-based compensation expense as follows:

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	Three Months Ended June 30, 2018	2017 * As adjusted	Six Months Ended June 30, 2018	2017 * As adjusted
Cost of revenue	$3,474	$ 2,156	$6,572	$ 4,260
Research and development	9,529	7,584	19,758	14,498
Sales and marketing	9,178	5,884	17,186	11,408
General and administrative	5,967	5,321	11,619	9,883

	Three Months Ended June 30, 2018	2017 * As adjusted	Six Months Ended June 30, 2018	2017 * As adjusted
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenue (2)	31.1	30.0	30.6	30.0
Gross profit	68.9	70.0	69.4	70.0
Operating expenses (2):				
Research and development	26.5	28.1	27.5	28.1
Sales and marketing	48.9	49.4	49.5	49.3
General and administrative	17.1	19.4	17.1	19.4
Total operating expenses	92.5	96.9	94.1	96.8
Operating loss	(23.6)	(26.9)	(24.7)	(26.8)
Other income (expense), net				
Interest income	2.7	0.8	2.0	0.8
Interest expense	(4.4)	—	(2.6)	—
Other income (expense), net	—	(0.3)	0.1	(0.4)
Total other income (expense), net	(1.7)	0.5	(0.5)	0.4
Loss before benefit from income taxes	(25.3)	(26.4)	(25.2)	(26.4)
Benefit from income taxes	(1.2)	(0.7)	(1.8)	(0.3)
Net loss	(24.1)%	(25.7)%	(23.4)%	(26.1)%

(2) Includes share-based compensation expense as follows:

	Three Months Ended June 30, 2018	2017 * As adjusted	Six Months Ended June 30, 2018	2017 * As adjusted
Cost of revenue	2.4%	2.1 %	2.4%	2.2 %
Research and development	6.7	7.4	7.3	7.4
Sales and marketing	6.5	5.8	6.3	5.8
General and administrative	4.2	5.2	4.3	5.0

*Adjusted to reflect the adoption of ASC 606. See Note 1 of the notes to our condensed consolidated financial statements.

Revenue

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017 * As adjusted	% Change	2018	2017 * As adjusted	% Change
	(In thousands, except percentages)					
Revenue	$141,882	$102,096	39 %	$271,673	$195,984	39 %

Revenue increased $39.8 million, or 39%, in the three months ended June 30, 2018 compared to the same period in 2017. Of the total increase in revenue, $15.5 million, or 39%, was attributable to revenue from new customer accounts acquired

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from July 1, 2017 through June 30, 2018, net of churn and contraction, and $24.3 million, or 61%, was attributable to revenue from accounts existing on or before June 30, 2017, net of churn and contraction. Revenue increased $75.7 million, or 39%, in the six months ended June 30, 2018 compared to the same period in 2017 due to the addition of new customer accounts and the continued expansion of existing customer accounts.

Cost of Revenue and Gross Margin

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017 * As adjusted	% Change	2018	2017 * As adjusted	% Change
	(In thousands, except percentages)					
Cost of revenue	$44,160	$30,663	44 %	$83,216	$58,770	42 %
Gross margin	68.9 %	70.0 %		69.4 %	70.0 %	

Cost of revenue increased $13.5 million, or 44%, and $24.4 million, or 42%, in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. The overall increase was primarily due to increased hosting costs of $5.9 million and $10.9 million, and increased employee compensation-related costs of $4.5 million and $8.2 million for the three and six months ended June 30, 2018, respectively. The increase in hosting costs was driven by an increase in expenditures for third-party managed hosting services and accelerated depreciation expense for our self-managed colocation data centers in connection with our transition to third-party managed hosting services. The increase in employee compensation-related costs was driven by headcount growth. Further contributing to the overall increase was an increase in allocated shared facilities and information technology costs of $1.4 million and $2.8 million for the three and six months ended June 30, 2018, respectively.

Our gross margin decreased by 1.1 and 0.6 percentage points in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017, driven primarily by increased hosting costs in connection with our transition to third-party managed hosting services. The overall decrease was partially offset by lower amortization of capitalized internal-use software and certain acquired intangible assets.

Operating Expenses

Research and Development Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(In thousands, except percentages)					
Research and development	$37,624	$28,698	31 %	$74,708	$55,154	35 %

Research and development expenses increased $8.9 million, or 31%, and $19.6 million, or 35%, in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. The overall increase was primarily due to increased employee compensation-related costs of $7.5 million and $15.0 million, driven by headcount growth, and asset impairment losses of $0.2 million and $2.0 million for the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. Further contributing to the overall increase was an increase in allocated shared costs of $1.7 million and $3.0 million for the three and six months ended June 30, 2018, respectively.

Sales and Marketing Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change

		* As adjusted			* As adjusted	
	(In thousands, except percentages)					
Sales and marketing	$69,450	$50,412	38 %	$134,508	$96,681	39 %

*Adjusted to reflect the adoption of ASC 606. See Note 1 of the notes to our condensed consolidated financial statements.

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Sales and marketing expenses increased $19.0 million, or 38%, and $37.8 million, or 39%, in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. The overall increase was primarily due to increased employee compensation-related costs, including amortization of deferred commissions, of $13.6 million and $26.9 million, driven by headcount growth, and an increase in marketing program costs of $2.1 million and $4.6 million for the three and six months ended June 30, 2018, respectively. The increase in marketing program costs was primarily driven by an increased number of marketing events and advertising activities. Further contributing to the overall increase was an increase in allocated shared costs of $2.9 million and $5.6 million, respectively.

General and Administrative Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(In thousands, except percentages)					
General and administrative	$24,245	$19,788	23 %	$46,452	$38,105	22 %

General and administrative expenses increased $4.5 million, or 23%, and $8.3 million, or 22%, in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. The overall increase was primarily due to increased employee compensation-related costs of $2.7 million and $5.4 million, driven by headcount growth, and an increase in allocated shared costs of $0.8 million and $1.6 million for the three and six months ended June 30, 2018, respectively.

Other Income (Expense), Net

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(In thousands, except percentages)					
Interest income	$3,826	$827	363 %	$5,344	$1,540	247 %
Interest expense	(6,289)	—	*	(7,053)	—	*
Other income (expense), net	27	(319)	(108)%	272	(814)	(133)%

* not meaningful

Interest income increased $3.0 million and $3.8 million in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017, primarily due to the increase in the amount of marketable securities from the proceeds received from the convertible senior notes. Interest expense increased $6.3 million and $7.1 million in the three and six months ended June 30, 2018, respectively, due to the issuance of the convertible senior notes.

Liquidity and Capital Resources

As of June 30, 2018, our principal sources of liquidity were cash, cash equivalents, and marketable securities totaling $873.0 million, which were held for working capital and general corporate purposes. Our cash equivalents and marketable securities are comprised of money market funds, corporate bonds, asset-backed securities, commercial paper, U.S. treasury securities, and agency securities.

The following table summarizes our cash flows for the periods indicated (in thousands):

	Six Months Ended June 30,	
	2018	2017 *As adjusted
Net cash provided by operating activities	$39,938	$17,577
Net cash used in investing activities	(169,780)	(28,957)

Net cash provided by financing activities	513,387	20,551

*Adjusted to reflect the adoption of ASC 606 and ASU 2016-18. See Note 1 of the notes to our condensed consolidated financial statements.

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To date, we have financed our operations primarily through customer payments for subscription services, the issuance of our convertible senior notes, and public and private equity financings. We believe that our existing cash, cash equivalents, and marketable securities balances, together with cash generated from operations, will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months.

Our future capital requirements will depend on many factors, including hosting costs to support the growth in our customer accounts and continued customer expansion, the timing and extent of spending to support product development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced products, features, and functionality, and costs related to building out our leased office facilities. We may in the future enter into arrangements to acquire or invest in complementary businesses, services, and technologies, and intellectual property rights. We may be required to seek additional equity or debt financing in order to meet these future capital requirements. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us, or at all. If we are unable to raise additional capital when desired, our business, results of operations, and financial condition would be adversely affected.

Operating Activities

Our largest source of operating cash inflows is cash collections from our customers. Our primary uses of cash from operating activities are for employee-related expenditures, hosting costs, office facilities, and marketing programs. Net cash provided by operating activities in the six months ended June 30, 2018 was $39.9 million, reflecting our net loss of $63.7 million, adjusted by non-cash charges including share-based compensation expense of $55.1 million, depreciation and amortization of $18.7 million, amortization of deferred costs of $9.5 million, and net changes in operating assets and liabilities of $11.4 million. The net changes in operating assets and liabilities were primarily attributable to an increase in deferred revenue of $33.6 million due to sales growth and the timing of customer billings and an increase in accounts payable and accrued liabilities of $21.8 million due to timing of payments. These sources of cash flow were offset by an increase in deferred costs of $17.6 million, primarily including sales commissions, and an increase in accounts receivable of $13.9 million due to the timing of customer billings and collections.

Net cash provided by operating activities in the six months ended June 30, 2017 was $17.6 million, reflecting our net loss of $51.3 million, adjusted by non-cash charges including share-based compensation expense of $40.0 million, depreciation and amortization of $16.1 million, amortization of deferred costs of $6.6 million, and net changes in operating assets and liabilities of $5.8 million. The net changes in operating assets and liabilities were primarily attributable to an increase in deferred revenue of $16.9 million due to sales growth and the timing of customer billings, and an increase in accrued liabilities and accounts payable of $8.0 million due to timing of payments. These sources of cash flow were offset by an increase in deferred costs of $9.6 million, primarily including sales commissions, and an increase in accounts receivable of $4.6 million due to the timing of customer billings and collections. Other uses of cash included an increase in prepaid expenses and other current assets of $2.9 million driven by a prepayment for third-party managed hosting services.

Investing Activities

Net cash used in investing activities in the six months ended June 30, 2018 of $169.8 million was primarily attributable to purchases of marketable securities of $145.6 million, net of sales and maturities, purchases of property and equipment of $20.0 million, primarily associated with newly leased office facilities, and capitalized internal-use software costs of $4.2 million related to the development of additional features and functionality for our platform.

Net cash used in investing activities in the six months ended June 30, 2017 of $29.0 million was primarily attributable to cash paid for the acquisition of Outbound, net of cash acquired, of $16.5 million, purchases of property and equipment of $9.3 million, primarily associated with hosting equipment to maintain our self-managed colocation data centers and newly leased office facilities, and capitalized internal-use software costs of $3.3 million related to the development of additional features and functionality for our platform.

Financing Activities

Net cash provided by financing activities in the six months ended June 30, 2018 of $513.4 million was primarily attributable to net proceeds from the issuance of our convertible senior notes of $561.5 million, proceeds from our employee stock purchase plan of $9.9 million, and proceeds from the exercise of employee stock options of $9.7 million, partially offset by the purchase of the capped call in connection with the issuance of our convertible senior notes of $63.9 million.

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Net cash provided by financing activities in the six months ended June 30, 2017 of $20.6 million was primarily attributable to proceeds from the exercise of employee stock options of $15.2 million and proceeds from our employee stock purchase plan of $7.1 million.

Critical Accounting Polices and Estimates

We prepare our condensed consolidated financial statements in accordance with GAAP. In the preparation of these condensed consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations would be affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies and estimates.

Except for updates to our accounting policies related to the adoption of ASC 606, there were no changes to our critical accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 22, 2018, that had a material impact on our condensed consolidated financial statements and related notes.

Recently Issued and Adopted Accounting Pronouncements

Refer to Note 1 of the notes to our condensed consolidated financial statements for a summary of recently issued and adopted accounting pronouncements, including our updated accounting policies related to the adoption of ASC 606.

Contractual Obligations and Other Commitments

Our principal commitments consist of obligations under operating leases for office facilities and contractual commitments for hosting and other support costs.

There were no material changes to our commitments under contractual obligations from those disclosed in our audited consolidated financial statements for the year ended December 31, 2017.

Off-Balance Sheet Arrangements

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Through June 30, 2018, we did not have any relationships with unconsolidated organizations or financial partnerships, such 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.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Exchange Rate Risk

While we primarily transact with customers in the U.S. dollar, we also transact in foreign currencies, including the Euro, British Pound Sterling, Australian Dollar, Singapore Dollar, Danish Krone, Brazilian Real, Philippine Peso, Japanese Yen, and Indian Rupee, due to foreign operations and customer sales. We expect to continue to grow our foreign operations and customer sales. Our international subsidiaries maintain certain asset and liability balances that are denominated in currencies other than the functional currencies of these subsidiaries, which is the U.S. dollar for all international subsidiaries. Changes in the value of foreign currencies relative to the U.S. dollar can result in fluctuations in our total assets, liabilities, revenue, operating expenses, and cash flows.

We operate a hedging program to mitigate the impact of foreign currency fluctuations on our cash flows and earnings. For additional information, see Note 3 of the notes to our condensed consolidated financial statements.

Interest Rate Sensitivity

We had cash, cash equivalents, and marketable securities totaling $873.0 million as of June 30, 2018, of which $817.8 million was invested in money market funds, corporate bonds, asset-backed securities, commercial paper, U.S. treasury securities, and agency securities. The cash and cash equivalents are held for working capital and general corporate purposes. Our investments in marketable securities are made for capital preservation purposes. We do not enter into investments for trading or speculative purposes.

Our cash equivalents and our portfolio of marketable securities are subject to market risk due to changes in interest rates. Fixed rate securities may have their market value adversely affected due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fluctuate due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. However, because we classify our debt securities as “available for sale,” no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary.

As of June 30, 2018, an immediate increase of 100-basis points in interest rates would have resulted in a decline in the fair value of our cash equivalents and portfolio of marketable securities of approximately $3.6 million. This estimate is based on a sensitivity model that measures market value changes when changes in interest rates occur. Fluctuations in the value of our cash equivalents and portfolio of marketable securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities prior to maturity or declines in fair value are determined to be other than temporary.

In March 2018, we issued $575.0 million aggregate principal amount of 0.25% convertible senior notes due 2023. The fair value of our convertible senior notes is subject to interest rate risk, market risk and other factors due to the conversion feature. The fair value of the convertible senior notes will generally increase as our common stock price increases and will generally decrease as our common stock price declines. The interest and market value changes affect the fair value of our convertible senior notes but do not impact our financial position, cash flows or results of operations due to the fixed nature of the debt obligation. Additionally, we carry the convertible senior notes at face value less unamortized discount on our balance sheet, and we present the fair value for required disclosure purposes only.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures and internal control over financial reporting must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management’s evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be subject to legal proceedings, claims, investigations, and government inquires in the ordinary course of business. We have received, and may in the future continue to receive, claims from third parties asserting, among other things, infringement of their intellectual property rights, defamation, privacy, and contractual rights. Legal risk is enhanced in certain jurisdictions outside the United States where our protection from liability for content added to our products by third parties may be unclear and where we may be less protected under local laws than we are in the United States. Future litigation may be necessary to defend ourselves, our partners, and our customers by determining the scope, enforceability, and validity of third-party proprietary rights, or to establish our proprietary rights. The results of any current or future litigation cannot be predicted with certainty, and regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

Item 1A. Risk Factors

A description of the risks and uncertainties associated with our business is set forth below. You should carefully consider such risks and uncertainties, together with the other information contained in this report, and in our other public filings. If any of such risks and uncertainties actually occurs, our business, financial condition, or operating results could differ materially from the plans, projections, and other forward-looking statements included in the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this report and in our other public filings. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occurs, our business, financial condition, or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly.

Risks Related to Our Business

We derive, and expect to continue to derive, substantially all of our revenue and cash flows from Support. If we fail to adapt this product to changing market dynamics and customer preferences or to achieve increased market acceptance of Support, our business, results of operations, financial condition, and growth prospects would be harmed.

We derive, and expect to continue to derive, substantially all of our revenue and cash flows from sales of subscriptions to Support. As such, the market acceptance of this product is critical to our success. Demand for our products, including Support, is affected by a number of factors, many of which are beyond our control, such as continued market acceptance of our products by customers for existing and new use cases, the timing of development and release of new products, features, and functionality introduced by our competitors, technological change, and growth or contraction in our addressable market. We expect that an increasing focus on the customer experience and the growth of various communications channels will profoundly impact the market for customer support software and blur distinctions between traditionally separate systems for customer support, marketing automation, and customer relationship management, enabling new competitors to emerge. If we are unable to meet customer demands to improve relationships between organizations and their customers through flexible solutions designed to address all these needs or otherwise achieve more widespread market acceptance of our products, including Support, our business, results of operations, financial condition, and growth prospects will be adversely affected.

We have a history of losses and we expect our revenue growth rate to decline. As our costs increase, we may not be able to generate sufficient revenue to achieve and sustain our profitability.

We have incurred net losses in each year since our inception, including net losses of $34.4 million and $26.3 million in the three months ended June 30, 2018 and 2017, respectively, and $63.7 million and $51.3 million in the six months ended June 30, 2018 and 2017, respectively. We had an accumulated deficit of $461.7 million as of June 30, 2018. For the three months ended June 30, 2018 and 2017, our revenue was $141.9 million and $102.1 million, respectively, representing a 39% growth rate. For the six months ended June 30, 2018 and 2017, our revenue was $271.7 million and $196.0 million, respectively, representing a 39% growth rate. Our historical revenue growth has been inconsistent, and should not be considered indicative of our future performance. We expect that our revenue growth rate will decline over time. We may not be able to generate sufficient revenue to achieve and sustain profitability as we also expect our costs to increase in future periods. We expect to continue to expend substantial financial and other resources on:

- development of our family of products, including investments in our research and development team, the development or acquisition of new products, features, and functionality, and improvements to the scalability, availability, and security of our products;
- enhancements to our network operations and infrastructure;
- sales and marketing, including an expansion of our direct sales organization;
- continued international expansion in an effort to increase our customer base and sales; and
- general administration, including legal, accounting, and other expenses related to being a public company.

These investments may not result in increased revenue or growth of our business. If we fail to continue to grow our revenue, our operating results and business would be harmed.

We face a number of risks in our strategy to increasingly target larger organizations for sales of our products and, if we do not manage these efforts effectively, our business and results of operations could be adversely affected.

As we target more of our sales efforts to larger organizations, we expect to incur higher costs and longer sales cycles, and we may be less effective at predicting when we will complete these sales. In this market segment, the decision to subscribe to one or more of our products may require the approval of a greater number of technical personnel and management levels within a potential customer's organization than we have historically encountered, and if so, these types of sales would require us to invest more time educating these potential customers on the benefits of our products. In addition, larger organizations may demand more features and integration services. We have limited experience in developing and managing sales channels and distribution arrangements for larger organizations. As a result of these factors, these sales opportunities may require us to devote greater research and development, sales, product support, and professional services resources to individual customers, resulting in increased costs and reduced profitability, and would likely lengthen our typical sales cycle, which could strain our resources. Moreover, these transactions may require us to delay recognizing portions of the associated revenue we derive from these customers until any technical or implementation requirements have been met, and larger customers may demand discounts to the subscription prices they pay for our products. Furthermore, because we have limited experience selling to larger organizations, our investment in marketing our products to these potential customers may not be successful, which could harm our results of operations and our overall ability to grow our customer base. Following sales to larger organizations, we may have fewer opportunities to expand usage of our products or to sell additional functionality, and we may experience increased subscription terminations as compared to our experience with smaller organizations, any of which could harm our results of operations.

Failure to effectively expand and maintain our sales capabilities could harm our ability to increase our customer base and achieve broader market acceptance of our products.

Increasing our customer base and achieving broader market acceptance of our products will depend, to a significant extent, on our ability to effectively expand and maintain our sales and marketing operations and activities. We are substantially dependent on our direct sales force to obtain certain of our new customers, including larger organizations. We plan to continue to expand our direct sales force both domestically and internationally to increase our sales capacity. During the twelve months ended June 30, 2018, our sales and marketing organization increased by approximately 190 employees to approximately 760 employees. There is significant competition for experienced sales and marketing professionals with the skills and technical knowledge that we require. Our ability to achieve significant revenue growth in the future will depend, in part, on our success in recruiting, training, and retaining a sufficient number of experienced sales and marketing professionals. New hires require significant training and time before they achieve full productivity, particularly in new sales segments and territories. Our recent hires and planned hires may not become as productive as we anticipate as quickly as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do business. We cannot predict whether, or to what extent, our sales will increase as we expand our sales and marketing functions or how long it will take for new personnel to become productive. Our business will be harmed if our sales and marketing efforts do not generate a significant increase in revenue.

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

The market for customer service solutions is fragmented, rapidly evolving, and highly competitive, with relatively low barriers to entry. With respect to larger organizations and enterprises seeking to deploy a customer service software system, we have many competitors that are larger than us and which have greater name recognition, much longer operating histories, more established customer relationships, larger marketing budgets, and significantly greater resources than we do. Among the small to medium-sized organizations that make up a large proportion of our customers, we often compete with general use computer applications and other tools, which these organizations use to provide support and which can be deployed for little or no cost.

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These include shared accounts for email communication, phone banks for voice communication, and pen and paper, text editors, and spreadsheets for tracking and management.

Our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards, or customer requirements. With the introduction of new technologies, the evolution of our products, and new market entrants, we expect competition to intensify in the future. Pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses, or the failure of our products to achieve or maintain more widespread market acceptance, any of which could harm our business.

We face competition from in-house software systems, large integrated systems vendors, and smaller companies offering alternative SaaS applications. Our competitors vary in size and in the breadth and scope of the products and services they offer. For larger organizations, we compete with customer software systems and large enterprise software vendors such as salesforce.com, Inc., Oracle Corporation, Microsoft Corporation, and ServiceNow, Inc., each of which may have greater operational flexibility to bundle competing products and services with other software offerings, or offer them at a lower price than our current Suite offering, which will negatively affect our competitiveness for that offering. In addition, we compete with a number of other SaaS providers with focused applications competitive to one or more of our products, including applications developed by Freshworks, Inc. and desk.com (a salesforce.com service) that compete with Support. Further, other established SaaS providers not currently focused on the functionality that our products provide may expand their services to compete with us. Many of our current and potential competitors have established marketing relationships, access to larger customer bases, pre-existing customer relationships, and major distribution agreements with consultants, system integrators, and resellers. Additionally, some existing and potential customers, particularly large organizations, have elected, and may in the future elect, to develop their own internal customer support software system. Certain of our competitors have partnered with, or have acquired, and may in the future partner with or acquire, other competitors to offer services, leveraging their collective competitive positions, which makes, or would make, it more difficult for us to compete with them. For all of these reasons, we may not be able to compete successfully against our current and future competitors or retain existing customers, which would harm our business.

Our business depends substantially on our customers renewing their subscriptions, expanding the use of their subscriptions, and purchasing subscriptions for additional products from us. Any decline in our customer retention or expansion, or any failure by us to sell subscriptions to additional products to existing customers, would harm our future operating results.

In order for us to maintain or improve our operating results, it is important that our customers renew their subscriptions when the initial contract term expires, and add additional authorized agents to their customer accounts. Even though the majority of our revenue is derived from subscriptions to our products that have terms longer than one month, a significant portion of the subscriptions to our products have monthly terms. Our customers have no obligation to renew their subscriptions, and our customers may not renew subscriptions with a similar contract period or with the same or a greater number of agents. Some of our customers have elected not to renew their agreements with us and it is difficult to accurately predict long-term customer retention. Additionally, our future success is also substantially dependent on our ability to expand our existing customers' use of our products by expanding the number of products to which such customers subscribe. This may require increasingly sophisticated and costly sales efforts and may not result in additional sales.

Our customer retention, our ability to sell additional products to existing customers, and the rate at which our existing customers purchase subscriptions to additional products may be impacted by a number of factors, including our customers’ satisfaction with our products, our product support, our prices, the prices of competing software systems, mergers and acquisitions affecting our customer base, the effects of global economic conditions, or reductions in our customers’ spending levels. In addition, the rate at which our existing customers purchase subscriptions to additional products depends on a number of factors, including the perceived need for additional products to build better relationships between organizations and their customers. If our customers do not renew their subscriptions, renew on less favorable terms, fail to add more agents, or fail to purchase subscriptions to additional products, our revenue may decline, and we may not realize improved operating results from our customer base.

We may not be able to integrate new products into our infrastructure, which could negatively impact our future sales and results of operations.

Our business depends in part on our ability to build or acquire products that both complement our existing products and respond to our customers' needs. Our customers also expect that new products will integrate with existing products that we currently offer. Our ability to successfully integrate newly developed or acquired products into a shared services infrastructure is unproven. Because we have a limited history in integrating newly developed or acquired products and the market for such products is rapidly evolving, it is difficult for us to predict our operating results following the integration of such products. If we are not able to fully integrate new products into our infrastructure, our business could be harmed.

If we are not able to develop enhancements to our products or introduce new products and services that achieve market acceptance and that keep pace with technological developments, our business would be harmed.

Our ability to attract new customers and increase revenue from existing customers depends in large part on our ability to enhance and improve our products and to introduce new products and services. In order to grow our business, we must research and develop products and services that reflect the changing nature of customer service, and expand beyond customer service to other areas of improving relationships between organizations and their customers. In the three months ended June 30, 2018 and 2017, our research and development expenses were 27% and 28% of our revenue, respectively. In each of the six months ended June 30, 2018 and 2017, our research and development expenses were 28% of our revenue. If we do not spend our research and development budget efficiently or effectively on compelling innovation and technologies, our operating results may be harmed and we may not realize the expected benefits of our strategy.

The success of any enhancement to our products depends on several factors, including timely completion, adequate quality testing, and market acceptance. Any new product or service that we develop may not be introduced in a timely or cost-effective manner, may contain defects, or may not achieve the market acceptance necessary to generate sufficient revenue. If we are unable to successfully develop new products or services, enhance our existing products to meet customer requirements, or otherwise gain market acceptance, our business and operating results will be harmed.

Because our products are available over the Internet, we need to continuously modify and enhance them to keep pace with changes in Internet-related hardware, software, communications, and database technologies and standards. If we are unable to respond in a timely and cost-effective manner to these rapid technological developments and changes in standards, our products may become less marketable, less competitive, or obsolete, and our operating results will be harmed.

We employ a pricing model that subjects us to various challenges that could make it difficult for us to derive sufficient value from our customers.

We generally charge our customers for their use of our products based on the number of users they enable as “agents” to provide customer service under their customer account, as well as the features and functionality enabled. The features and functionality we provide within our products enable our customers to promote customer self-service and otherwise efficiently and cost-effectively address product support requests without the need for substantial human interaction. As a result of these features, customer agent staffing requirements may be minimized and our revenue may be adversely impacted. Additionally, other than subscriptions related to our Suite offering, we generally require a separate subscription to enable the functionality of each of our products. We do not know whether our current or potential customers or the market in general will accept this pricing model going forward and, if it fails to gain acceptance, our business and results of operations could be harmed.

Our terms of service generally prohibit the sharing of user logins and passwords. These restrictions may be improperly circumvented or otherwise bypassed by certain users and, if they are, we may not be able to capture the full value of the use of our products. We license access and use of our products exclusively for our customers’ internal use. If customers improperly resell or otherwise make our products available to their customers, it may cannibalize our sales or commoditize our products in the market. Additionally, if a customer that has received a volume discount from us offers our products to its customers in violation of our terms of service, we may experience price erosion and be unable to capture sufficient value from the use of our products by those customers.

While our terms of service provide us the ability to enforce our terms, our customers may resist or refuse to allow us to audit their usage, in which case we may have to pursue legal recourse to enforce our rights. Any such enforcement action would require us to spend money, distract management, and potentially adversely affect our relationship with our customers.

We do not have the history with our subscription or pricing models that we need to accurately predict optimal pricing necessary to attract new customers and retain existing customers.

We have limited experience with respect to determining the optimal prices for our products and, as a result, we have in the past and expect in the future that we will need to change our pricing model from time to time. As the market for our products matures, or as new competitors introduce new products or services that compete with ours, we may be unable to attract new customers at the same price or based on the same pricing models as we have used historically. Pricing decisions may also impact the mix of adoption among our subscription plans and negatively impact our overall revenue. Moreover, larger organizations may demand substantial price concessions. As a result, in the future we may be required to reduce our prices or

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develop new pricing models, which could adversely affect our revenue, gross margin, profitability, financial position, and cash flow.

Additionally, we have a very limited history in respect of pricing our Suite offering. We may not fully understand the impact of pricing changes in the market, and if we fail to find an optimal price for our Suite offering, our business and results of operations may be harmed.

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

We have experienced and may continue to experience rapid growth and organizational change, which has placed, and may continue to place, significant demands on our management, operational, and financial resources. For example, our headcount has grown from approximately 1,880 employees as of June 30, 2017 to approximately 2,360 employees as of June 30, 2018. In addition, we have established subsidiaries in Denmark, the United Kingdom, Australia, Ireland, Japan, the Philippines, Brazil, Germany, India, and Mexico since our inception in 2007, and, as a result of acquisitions, we also have subsidiaries in Singapore and France. We may continue to expand our international operations into other countries in the future. We have also experienced significant growth in the number of customers, end users, transactions, and data that our products support. Finally, our organizational structure is becoming more complex and we may need to scale and adapt our operational, financial, and management controls, as well as our reporting systems and procedures, to manage this complexity. We will require significant capital expenditures and the allocation of valuable management resources to grow and change in these areas without undermining our corporate culture of rapid innovation, simplicity in design, and attention to customer satisfaction that has been critical to our growth so far. If we fail to manage our anticipated growth and change in a manner that preserves the key aspects of our culture, the quality of our products and services may suffer, which could negatively affect our brand and reputation and harm our ability to retain and attract customers.

If the market for SaaS business software applications develops more slowly than we expect or declines, our business would be adversely affected.

The market for SaaS business software applications is less mature than the market for on-premise business software applications, and the adoption rate of SaaS business software applications may be slower among subscribers in industries with heightened data security interests or business practices requiring highly customizable application software. Our success will depend to a substantial extent on the widespread adoption of SaaS business applications in general, and of SaaS customer service applications in particular. Many organizations have invested substantial personnel and financial resources to integrate traditional on-premise business software applications into their businesses, and therefore may be reluctant or unwilling to migrate to SaaS applications. The expansion of the SaaS business applications market depends on a number of factors, including the cost, performance, and perceived value associated with SaaS, as well as the ability of SaaS providers to address data security and privacy concerns. If SaaS business applications do not continue to achieve market acceptance, if there is a reduction in demand for SaaS business applications caused by a lack of customer acceptance, or if there are technological challenges, weakening economic conditions, data security or privacy concerns, governmental regulation, competing technologies and products, or decreases in information technology spending, it would result in decreased revenue and our business would be adversely affected.

If our network or computer systems are breached or unauthorized access to customer data is otherwise obtained, our products may be perceived as insecure, we may lose existing customers or fail to attract new customers, and we may incur significant liabilities.

Use of our products involves the storage, transmission, and processing of our customers' proprietary data, including personal or identifying information regarding their customers or employees. Unauthorized access to or security breaches of our products could result in the loss of data, loss of intellectual property or trade secrets, loss of business, severe reputational damage adversely affecting customer or investor confidence, regulatory investigations and orders, litigation, or indemnity obligations. Furthermore, if our network or computer systems are breached or unauthorized access to customer data is otherwise obtained, we may be held responsible for damages for contract breach, penalties for violation of applicable laws, regulations, or contractual obligations, and significant costs for remediation that may include liability for stolen assets or information and repair of system damage that may have been caused, incentives offered to customers or other business partners in an effort to maintain business relationships after a breach, and other liabilities. Notifications related to a security breach regarding or pertaining to any of such service providers could impact our reputation, harm customer confidence, hurt our sales and expansion into new markets, or cause us to lose existing customers. We have incurred, and expect to continue to incur, significant expenses to prevent, investigate, and remediate security breaches and vulnerabilities, including deploying additional personnel and protection technologies, training employees, and engaging third-party experts and consultants. Our errors and

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omissions insurance coverage covering certain security and privacy damages and claim expenses may not be sufficient to compensate for all liability.

We have previously experienced significant breaches and identified significant vulnerabilities of our security measures and the security measures deployed by third-party vendors upon which we rely, and our products are at risk for future breaches as a result of third-party action, employee, vendor, or contractor error, malfeasance, or other factors.

New products and services, including newly acquired products and services, may rely on systems, networks, personnel, equipment, and vendors that may initially be different from those utilized in connection with our existing products and may not have been subject to the same security reviews and assessments as those used to provide our existing products. Any failure to complete these security reviews and assessments and to implement improvements to the security measures deployed to protect our new products in a timely manner could increase our risk of a security breach with respect to these products, which would harm our reputation and our business as a whole.

Because the techniques used and vulnerabilities exploited to obtain unauthorized access to or to sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or vulnerabilities or to implement adequate preventative measures. We may also experience security breaches that may remain undetected for an extended period.

Because data security is a critical competitive factor in our industry, we make numerous statements in our privacy policies, terms of service, and data processing agreements, through our certifications to privacy standards, and in our marketing materials, providing assurances about the security of our products, including detailed descriptions of security measures we employ. Should any of these statements be untrue or become untrue, even due to circumstances beyond our reasonable control, we may face claims of misrepresentation or deceptiveness by the U.S. Federal Trade Commission, state and foreign regulators, and private litigants.

Our financial results may fluctuate due to increasing variability in our sales cycles.

We plan our expenses based on certain assumptions about the length and variability of our sales cycle. These assumptions are based upon historical trends for sales cycles and conversion rates associated with our existing customers, many of whom to date have been small to medium-sized organizations that make purchasing decisions with limited interaction with our sales or other personnel. As we continue to become more dependent on sales to larger organizations, we expect our sales cycles to lengthen and become less predictable. This may adversely affect our financial results. Factors that may influence the length and variability of our sales cycle include:

- the need to educate prospective customers about the uses and benefits of our products;
- the discretionary nature of purchasing and budget cycles and decisions;
- the competitive nature of evaluation and purchasing processes;
- announcements or planned introductions of new products, features, or functionality by us or our competitors; and
- lengthy purchasing approval processes.

An increasing dependence on sales to larger organizations may increase the variability of our financial results. If we are unable to close one or more expected significant transactions with these customers in a particular period, or if an expected transaction is delayed until a subsequent period, our operating results for that period, and for any future periods in which revenue from such transaction would otherwise have been recognized, may be adversely affected.

Our quarterly results may fluctuate for various other reasons, and if we fail to meet the expectations of analysts or investors, our stock price and the value of an investment in our common stock could decline substantially.

Our quarterly financial results may fluctuate as a result of a variety of other factors, many of which are outside of our control. If our quarterly financial results fall below the expectations of investors or any securities analysts who follow our stock, the price of our common stock could decline substantially. Some of the important factors that may cause our revenue, operating results, and cash flows to fluctuate from quarter to quarter include:

- our ability to attract new customers, retain and increase sales to existing customers, and satisfy our customers' requirements;
- the number of new employees added to our company in a given period;

- the rate of expansion and productivity of our sales force;
- changes in our or our competitors' pricing policies;

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- the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;
- new products, features, or functionalities introduced by our competitors;
- increasing efforts by our customers to develop native applications as a substitute for our own;
- significant security breaches, technical difficulties, or service interruptions to our products;
- the timing of customer payments and payment defaults by customers;
- general economic conditions that may adversely affect either our customers' ability or willingness to purchase additional subscriptions, delay a prospective customer's purchasing decision, reduce the value of new subscription contracts, or affect customer retention;
- changes in the relative and absolute levels of professional services we provide;
- changes in foreign currency exchange rates;
- extraordinary expenses such as litigation or other dispute-related settlement payments;
- the impact of new accounting pronouncements; and
- the timing of the grant, price of our common stock, or vesting of equity awards to employees.

Many of these factors are outside of our control, and the occurrence of one or more of them might cause our revenue, operating results, and cash flows to vary widely. As such, we believe that quarter-to-quarter comparisons of our revenue, operating results, and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

Interruptions or performance problems associated with our technology and infrastructure may adversely affect our business and operating results.

Our continued growth depends in part on the ability of our existing and potential customers to access our products at any time and within an acceptable amount of time. Our products are proprietary, and we rely on the expertise of members of our engineering, operations, and software development teams for their continued performance. We have experienced, and may in the future experience, disruptions, outages, and other performance problems due to a variety of factors, including infrastructure changes, introductions of new functionality, human or software errors, capacity constraints due to an overwhelming number of users simultaneously accessing our products, distributed denial of service attacks, or other security related incidents. In some instances, we may not be able to identify the cause or causes of these performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve our performance, especially during peak usage times and as our products become more complex and our user traffic increases. If any of our products are unavailable or if our users are unable to access our products within a reasonable amount of time or at all, our business would be negatively affected. In addition, a significant portion of our infrastructure does not currently support the mirroring of data. Therefore, in the event of any of the factors described above, or certain other failures of our infrastructure, customer data may be permanently lost. Moreover, some of our customer agreements and certain subscription plans include performance guarantees and service level standards that obligate us to provide credits or termination rights in the event of a significant disruption in our services. To the extent that we do not effectively address capacity constraints, upgrade our systems as needed, and continually develop our technology and network architecture to accommodate actual and anticipated changes in technology, our business and operating results may be adversely affected.

Real or perceived errors, failures, or bugs in our products could adversely affect our operating results and growth prospects.

Because our products are complex, undetected errors, failures, vulnerabilities, or bugs may occur, especially when updates are deployed. Our products are often used in connection with large-scale computing environments with different operating systems, system management software, equipment, and networking configurations, which may cause errors or failures of our products or other aspects of the computing environment into which they are deployed. In addition, deployment of our products into complicated, large-scale computing environments may expose undetected errors, failures, vulnerabilities, or bugs in our products. We have discovered, and expect to continue to discover, software errors, failures, vulnerabilities, and bugs in our products, some of which have or may only be discovered and remediated after deployment to customers. Real or perceived errors, failures, vulnerabilities, or bugs in our products could result in negative publicity, loss of or delay in market acceptance of our products, loss of competitive position, or claims by customers for losses sustained by them. In such an event, we may be required, or may choose, for customer relations or other reasons, to expend additional resources in order to help correct the problem.

Incorrect or improper implementation or use of our products could result in customer dissatisfaction and negatively affect our business, results of operations, financial condition, and growth prospects.

Our products are deployed in a wide variety of technology environments and into a broad range of complex workflows. Increasingly, our products have been, and will continue to be, integrated into large-scale, complex technology environments

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and specialized use cases, and we believe our future success will depend on our ability to increase use of our products in such deployments. We often assist our customers in implementing our products, but many customers attempt to implement deployments, including complex deployments, themselves. If we or our customers are unable to implement our products successfully, or are unable to do so in a timely manner, customer perceptions of our products and of our company may be impaired, our reputation and brand may suffer, and customers may choose not to renew or expand the use of our products.

Our customers and third-party partners may need training in the proper use of our products to maximize their potential. If our products are not implemented or used correctly or as intended, inadequate performance may result. Because our customers rely on our products to manage a wide range of operations and to drive a number of their internal processes, the incorrect or improper implementation or use of our products, our failure to train customers on how to efficiently and effectively use our products or our failure to provide adequate product support to our customers, may result in negative publicity or legal claims against us. Also, as we continue to expand our customer base, any failure by us to properly provide these services will likely result in lost opportunities for additional subscriptions to our products.

Any failure to offer high-quality product support or customer success initiatives may adversely affect our relationships with our customers and our financial results.

In deploying and using our products, our customers depend on our product support team and customer success organization to resolve complex technical and operational issues. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for product support. We also may be unable to modify the nature, scope, and delivery of our product support to compete with changes in product support services provided by our competitors. Increased customer demand for product support, without corresponding revenue, could increase costs and adversely affect our operating results. Furthermore, adoption of Suite and increasing usage by customers of multiple products may additionally increase demand on our product support team and customer success organizations. Additionally, we may be unable to develop our customer success organization to continue to support the increasing level of complexity that larger enterprise customers require while maintaining the same level of engagement across all customers.

Our sales are highly dependent on our business reputation and on positive recommendations from our existing customers. Any failure to maintain high-quality product support, or a market perception that we do not maintain high-quality product support, or maintain a high complexity customer success organization, could adversely affect our reputation, our ability to sell our products to existing and prospective customers, and our business, operating results, and financial position.

We depend on our executive officers and other key employees and the loss of one or more of these employees or an inability to attract and retain highly skilled employees could adversely affect our business.

Our success depends largely upon the continued services of our executive officers and other key employees. We rely on our leadership team and on individual contributors in the areas of research and development, operations, security, sales, marketing, support, and general and administrative functions. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. We do not have employment agreements with our executive officers or other key personnel that require them to continue to work for us for any specified period of time and, therefore, they could terminate their employment with us at any time. The loss of one or more of our executive officers, especially our Chief Executive Officer, or other key employees could have an adverse effect on our business.

In addition, to execute on our growth plan, we must attract and retain highly qualified personnel. Competition for these personnel in the San Francisco Bay Area, where our headquarters is located, and in other locations where we maintain offices, is intense, especially for engineers experienced in designing and developing software and SaaS applications and experienced sales professionals. We have, from time to time, experienced, and we expect to continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. For example, certain domestic immigration laws restrict or limit our ability to recruit internationally. Any changes
to U.S. immigration policies that restrain the flow of technical and professional talent may inhibit our ability to recruit and retain highly qualified employees. Additionally, many of the companies with which we compete for experienced

personnel have greater resources than we have. If we hire employees from competitors or other companies, their former employers may attempt to assert that these employees or we have breached their legal obligations, resulting in a diversion of our time and resources. In addition, job candidates and existing employees often consider the value of the equity awards they receive in connection with their employment. If the perceived or actual value of our equity awards declines, it may adversely affect our ability to recruit and retain highly skilled employees. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be adversely affected.

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We are highly dependent upon free trials of our products and other inbound lead generation strategies to drive our sales and revenue. If these strategies fail to continue to generate sales opportunities or do not convert into paying customers, our business and results of operations would be harmed.

We are highly dependent upon our marketing strategy of offering free trials of our products and other inbound lead generation strategies to generate sales opportunities. These strategies may not be successful in continuing to generate sufficient sales opportunities necessary to increase our revenue. Many early users never convert from the trial version of a product to a paid version of such product. Further, we often depend on individuals within an organization who initiate the trial versions of our products being able to convince decision makers within their organization to convert to a paid version. Many of these organizations have complex and multi-layered purchasing requirements. To the extent that these users do not become, or are unable to convince others to become, paying customers, we will not realize the intended benefits of this marketing strategy and our ability to grow our revenue will be adversely affected.

If we are unable to develop and maintain successful relationships with channel partners, our business, operating results, and financial condition could be adversely affected.

To date, we have been primarily dependent on our direct sales force to sell subscriptions to our products. Although we have developed certain channel partners, such as referral partners, resellers, and integration partners, these channels have resulted in limited revenue to date. We believe identifying, developing, and maintaining strategic relationships with additional channel partners are important to driving revenue growth for our company, and will continue to dedicate resources to those efforts. Our agreements with our existing channel partners are non-exclusive, meaning our channel partners may offer customers the products of several different companies, including products that compete with ours. They may also cease marketing our products with limited or no notice and with little or no penalty. We expect that any additional channel partners we identify and develop will be similarly non-exclusive and not bound by any requirement to continue to market our products. If we fail to identify additional channel partners, in a timely and cost-effective manner, or at all, or are unable to assist our current and future channel partners in independently selling and deploying our products, our business, results of operations, and financial condition could be adversely affected. Additionally, customer retention and expansion attributable to customers acquired through our channel partners may differ significantly from customers acquired through our direct sales efforts. If our channel partners do not effectively market and sell our products, or fail to meet the needs of our customers, our reputation and ability to grow our business may also be adversely affected.

Sales by channel partners are more likely than direct sales to involve collectibility concerns. In particular sales by our channel partners into developing markets, and accordingly, variations in the mix between revenue attributable to sales by channel partners and revenue attributable to direct sales, may result in fluctuations in our operating results.

If we are not able to maintain and enhance our brand, our business, operating results, and financial condition may be adversely affected.

We believe that maintaining and enhancing our reputation as a differentiated and category-defining company in customer service is critical to our relationships with our existing customers and to our ability to attract new customers. The successful promotion of our brand attributes will depend on a number of factors, including our marketing efforts, our ability to continue to develop high-quality software, and our ability to successfully differentiate our products from competitive products and services. We are and have been highly dependent upon “consumer” tactics to build our brand and develop brand loyalty, but may need to increasingly spend significant energy to develop branding to retain and increase brand recognition with our customers who are larger enterprises. In addition, independent industry analysts often provide reviews of our products, as well as products and services offered by our competitors, and perception of our products in the marketplace may be significantly influenced by these reviews. If these reviews are negative, or less positive as compared to those of our competitors’ products and services, our brand may be adversely affected. It may also be difficult to maintain and enhance our brand, specifically following the launch of our updated corporate brand, in connection with sales through channel or strategic partners.

The promotion of our brand requires us to make substantial expenditures, and we anticipate that these expenditures will continue to increase, as our market becomes more competitive, as we expand into new markets, and as more sales are generated through our channel partners. To the extent that these activities yield increased revenue, this revenue may not offset the increased expenses we incur. If we do not successfully maintain and enhance our brand, our

business may not grow, we may have reduced pricing power relative to competitors, and we could lose customers or fail to attract potential customers, all of which would adversely affect our business, results of operations, and financial condition.
Our international sales and operations subject us to additional risks that can adversely affect our business, operating results, and financial condition.

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In the three months ended June 30, 2018 and 2017, we derived 49% and 46% of our revenue from customers located outside of the United States, respectively. In the six months ended June 30, 2018 and 2017, we derived 48% and 46% of our revenue from customers located outside of the United States, respectively. We are continuing to expand our international operations as part of our growth strategy. We currently have sales personnel and sales and product support operations in certain countries across North America, Europe, Australia, Asia, and South America. To date a very limited portion of our sales has been driven by resellers or other channel partners. We believe our ability to convince new customers to subscribe to our products or to convince existing customers to renew or expand their use of our products is directly correlated to the level of engagement we obtain with the customer. To the extent we are unable to effectively engage with non-U.S. customers due to our limited sales force capacity and limited channel partners, we may be unable to effectively grow in international markets.
Our international operations subject us to a variety of additional risks and challenges, including:

- increased management, travel, infrastructure, and legal compliance costs associated with having multiple international operations;
- longer payment cycles and difficulties in enforcing contracts, collecting accounts receivable, or satisfying revenue recognition criteria, especially in emerging markets;
- increased financial accounting and reporting burdens and complexities;
- requirements or preferences for domestic products;
- differing technical standards, existing or future regulatory and certification requirements, and required features and functionality;
- economic conditions in each country or region and general economic uncertainty around the world;
- compliance with foreign privacy and security laws and regulations and the risks and costs of non-compliance;
- compliance with laws and regulations for foreign operations, including anti-bribery laws (such as the U.S. Foreign Corrupt Practices Act of 1977, as amended, the U.S. Travel Act, and the U.K. Bribery Act 2010), import and export controls laws, tariffs, trade barriers, economic sanctions, and other regulatory or contractual limitations on our ability to sell our products in certain foreign markets, and the risks and costs of non-compliance;
- heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact our financial results and result in restatements of our consolidated financial statements;
- fluctuations in foreign currency exchange rates and the related effect on our operating results;
- difficulties in repatriating or transferring funds from or converting currencies in certain countries;
- communication and integration problems related to entering new markets with different languages, cultures, and political systems;
- differing labor standards, including restrictions related to, and the increased cost of, terminating employees in some countries;
- the need for localized software and licensing programs;
- the need for localized language support;
- reduced protection for intellectual property rights in some countries and practical difficulties of enforcing rights abroad; and
- compliance with the laws of numerous foreign tax jurisdictions, including withholding obligations, and overlapping of different tax regimes.

Any of these risks could adversely affect our international operations, reduce our international revenue, or increase our operating costs, adversely affecting our business, operating results, financial condition, and growth prospects.
Compliance with laws and regulations applicable to our international operations substantially increases our cost of doing business in foreign jurisdictions. We may be unable to keep current with new or revised government requirements as they change from time to time. Failure to comply with these regulations could have adverse effects on our business. Additionally, in many foreign countries it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. or other regulations applicable to us. Although we have implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no

assurance that all of our employees, contractors, partners, and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, partners, or agents could result in delays in revenue recognition, financial reporting misstatements, enforcement actions, disgorgement of profits, fines, civil and criminal penalties, damages, injunctions, other collateral consequences, or the prohibition of the importation or exportation of our products and services, and could adversely affect our business and results of operations.

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Because our products can be used to collect and store personal information, domestic and international privacy and data security concerns could result in additional costs and liabilities to us or inhibit sales of our products.

Personal privacy and data security have become significant issues in the United States, Europe, and in many other jurisdictions where we offer our products. The regulatory framework for privacy and security issues worldwide is rapidly evolving and is likely to remain uncertain for the foreseeable future. Many federal, state, and foreign government bodies and agencies have adopted, or are considering adopting, laws and regulations regarding the collection, use, and disclosure of personal information. In the United States, these include rules and regulations promulgated under the authority of federal agencies and state attorneys general and consumer protection agencies. Internationally, virtually every jurisdiction in which we operate has established its own data security and privacy legal framework with which we or our customers must comply, including the Directive, and data protection legislation of the individual member states subject to the Directive. On May 25, 2018, the Directive was replaced with the European General Data Protection Regulation, or the GDPR, which imposes additional obligations and risks upon our business. Compliance with GDPR has and will continue to require valuable management and employee time and resources, and failure to comply with GDPR could trigger severe penalties, including steep fines of up to €20.0 million or 4% of global annual revenue, whichever is higher, and could reduce demand for our products. In many jurisdictions enforcement actions and consequences for non-compliance are also rising.

Failure to comply with data protection regulations may result in data protection authorities and other privacy regimes imposing additional obligations to obtain consent from data subjects by or on behalf of our customers. Additionally, the inability to guarantee compliance or otherwise provide acceptable privacy assurances may inhibit the sale and use of our software in the European Union and certain other markets, which could, were it to occur, harm our business and operating results.

In addition to government regulation, privacy advocates and industry groups may propose new and different self-regulatory standards that either legally or contractually apply to us. Further, our customers may require us to comply with more stringent privacy and data security contractual requirements. Particularly in this regulatory environment, if we or other SaaS providers experience data security incidents, loss of customer data, disruptions in delivery, or other problems, the market for SaaS business applications, including our products, may be negatively affected.

Because the interpretation and application of many privacy and data protection laws (including the GDPR), commercial frameworks, and standards are uncertain, it is possible that these laws, frameworks, and standards may be interpreted and applied in a manner that is inconsistent with our existing data management practices or the features of our products. If so, in addition to the possibility of fines, lawsuits, breach of contract claims, and other claims and penalties, we could be required to fundamentally change our business activities and practices or modify our products, which could have an adverse effect on our business. Any inability to adequately address privacy and security concerns, even if unfounded, or comply with applicable privacy and security or data security laws, regulations, and policies, could result in additional cost and liability to us, damage our reputation, inhibit sales, and adversely affect our business.

Furthermore, the costs of compliance with, and other burdens imposed by, the laws, regulations, and policies that are applicable to the businesses of our customers may limit the use and adoption of, and reduce the overall demand for, our products. Privacy and data security concerns, whether valid or not valid, may inhibit market adoption of our products, particularly in certain industries and foreign countries.

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

Our operating results may vary based on the impact of changes in our industry or the global economy on us or our customers. The revenue growth and potential profitability of our business depend on demand for business software applications and services generally and for customer service systems in particular. In addition, our revenue is dependent on the number of users of our products which in turn is influenced by the employment and hiring patterns of our customers. To the extent that weak economic conditions cause our customers and prospective customers to freeze or reduce their hiring for personnel providing service and support, demand for our products may be negatively affected. Historically, during economic downturns there have been reductions in spending on information technology and customer service systems as well as pressure for extended billing terms and other financial concessions. If economic conditions deteriorate, our customers and prospective customers may elect to decrease their information technology and customer service budgets, which would limit our ability to grow our business and negatively affect our operating results.

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We are subject to governmental export and import controls that could impair our ability to compete in international markets or subject us to liability if we violate the controls.

We are subject to U.S. export controls, and we incorporate encryption technology into our products that is enabled through mobile applications and other software we may be deemed to export. These encryption products and the underlying technology may be exported outside of the U.S. only with the required export authorizations, including by license, a license exception, or other appropriate government authorizations, including the filing of an encryption registration. We previously deployed mobile applications prior to obtaining the required export authorizations. Accordingly, we have not fully complied with applicable encryption controls in U.S. export administration regulations.

Furthermore, U.S. export controls laws and economic sanctions prohibit the shipment of certain products and services to countries, governments, territories, and persons targeted by U.S. sanctions. While we are currently taking precautions to prevent our products from being enabled by persons targeted by U.S. sanctions, including IP blocking and periodic customer screening against U.S. government lists of prohibited persons, such measures may be circumvented. Given the technical limitations in developing measures that will prevent access to internet based services from particular geographies or by particular individuals, we have previously identified and expect we will continue to identify customer accounts for our products that we suspect originate from countries which are subject to U.S. embargoes.

We are aware that trials of and subscriptions to our products have been initiated by persons and organizations in countries that are the subject of U.S. embargoes. Our provision of services in these instances was likely in violation of U.S. export controls and sanctions laws. We have terminated the accounts of such organizations as we have become aware of them, implemented certain measures designed to prevent future unauthorized access by such persons and organizations, and filed voluntary self-disclosures with the U.S. Department of Commerce’s Bureau of Industry and Security, or BIS, and the U.S. Department of Treasury’s Office of Foreign Assets Control, or OFAC, concerning prior potential violations. With respect to these matters, each of BIS and OFAC completed its investigations, and no monetary penalties or other sanctions were imposed.

If we are found to be in violation of U.S. sanctions or export controls laws, it could result in fines or penalties for us and for individuals, including civil penalties of approximately $300,000 or twice the value of the transaction, whichever is greater, per violation, and in the event of conviction for a criminal violation, fines of up to $1 million and possible incarceration for responsible employees and managers for willful and knowing violations. Each instance in which we provide services through our products or in which unlicensed encryption functionality software is downloaded may constitute a separate violation of these laws.

If our channel partners fail to obtain appropriate import, export, or re-export licenses or permits, we may also be adversely affected, through reputational harm as well as other negative consequences, including government investigations and penalties. We presently incorporate sanctions compliance requirements in our channel partner agreements for our products. Complying with export controls and sanctions regulations for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities. Failure to comply with exports control and sanctions regulations for a particular sale may expose us to government investigations and penalties, which could have an adverse effect on our business, operating results, and financial condition.

In addition, various countries regulate the import of certain encryption technology, including import permitting and licensing requirements, and have enacted laws that could limit our ability to offer or distribute our products or could limit our customers’ ability to implement our products in those countries. Changes in our products or future changes in export and import regulations may create delays in the introduction of our products in international markets or prevent our customers with international operations from deploying our products globally. Any change in export or import regulations, economic sanctions, or related legislation, or change in the countries, governments, persons, or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business operations and financial results.

We recognize revenue over the term of our customer contracts. Consequently, downturns or upturns in new sales may not be immediately reflected in our operating results and may be difficult to discern.

We generally recognize subscription revenue from customers ratably over the terms of their contracts and a majority of our revenue is derived from subscriptions that have terms longer than one month. As a result, a portion of the revenue we report in each quarter is derived from the recognition of deferred revenue relating to subscriptions entered into during previous quarters. Consequently, a decline in new or renewed subscriptions with terms that are longer than one month in any single quarter may have a small impact on our revenue results for that quarter. However, such a decline will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our products, and potential changes in our pricing policies or rate of expansion or retention, may not be fully reflected in our results of operations until future periods. We may also be unable to reduce our cost structure in line with a significant deterioration in sales. In addition, because we believe a substantial percentage of subscriptions to our products are shorter than many comparable SaaS companies and because we have many variations of billing cycles, our deferred revenue may be a less meaningful indicator of our future financial results as compared to other SaaS companies. A significant majority of our costs are expensed as incurred, while revenue is recognized over the life of the agreement with the applicable customer. As a result, increased growth in the number of our customers could continue to result in our recognition of more costs than revenue in the earlier periods of the terms of our agreements. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

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

We have experienced, and expect to continue to experience in the future, seasonality in our business, and our operating results and financial condition may be affected by such trends in the future. We generally experience seasonal fluctuations in demand for our products and services, and believe that our quarterly sales are affected by industry buying patterns. For example, we typically have customers who add flexible agents when they need more capacity during busy periods, especially in the fourth quarter, and then subsequently scale back in the first quarter of the following year. We believe that the seasonal trends that we have experienced in the past may continue for the foreseeable future, particularly as we expand our sales to larger enterprises. Additionally, since a large percentage of our subscriptions are monthly, customers are able to increase and decrease the number of authorized agents for whom they require a subscription quickly and easily, thereby potentially increasing the impact of seasonality on our revenue. Seasonality within our business may be reflected to a much lesser extent, and sometimes may not be immediately apparent, in our revenue, due to the fact that we recognize subscription revenue over the term of our agreement. To the extent we experience this seasonality, it may cause fluctuations in our operating results and financial metrics, and make forecasting our future operating results and financial metrics difficult. Additionally, we do not have sufficient experience in selling certain of our products to determine if demand for these services are or will be subject to material seasonality.

Our ongoing and planned expenditures on third-party managed hosting services, investments in self-managed colocation data centers, and expenditures on transitioning our services and customers fully to third-party managed hosting services, are expensive and complex, have resulted, and will result, in a negative impact on our cash flows, and may negatively impact our financial results.

We have made and will continue to make substantial expenditures for third-party managed hosting services and investments in our self-managed colocation data centers to support our growth and provide enhanced levels of service to our customers. We recently decreased the amount of capital expenditures on hosting equipment for use in our self-managed colocation data centers as we transition to greater dependence on third-party managed hosting services, but expect to continue to incur significant expense to operate and maintain our self-managed colocation data centers. We have employed a hybrid hosting model in which we utilize managed hosting services, where a third party manages most aspects of our hosting operations, and self-managed colocation data centers, where we have more direct control over the hosting infrastructure and its operation. This has and may continue to have a negative impact on our cash flows and gross profit. If costs associated with third-party managed hosting services utilized to support our growth are greater than expected or if we are required to make larger investments in our self-managed colocation data centers than we anticipated, the negative impact on our operating results would likely exceed our initial expectations. Furthermore, if we determine to no longer utilize our self-managed colocation data centers, we may be forced to accelerate expense recognition as a result of the shorter estimated life of such assets.

We plan to continue to invest significant resources in connection with transitioning our customers and services infrastructure to third-party managed hosting services and may encounter obstacles in completing the transition. Given that we will increasingly become more reliant on third-party managed hosting services, any significant disruption of or interference in our use of such services will negatively impact our operations and customer satisfaction. In addition, third-party managed hosting services may take actions beyond our control that could seriously harm our business, including:

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- discontinuing or limiting our access to the services;
- increasing price terms, including establishing more favorable relationships or pricing terms with one or more of our competitors;
- terminating or seeking to terminate the contractual relationship altogether, or
- modifying or interpreting its terms of service or other policies in a manner that impacts our ability to run our businesses and operations.

Our business and growth depend in part on the success of our strategic relationships with third parties, including technology partners, channel partners, and professional services partners.

We depend on, and anticipate that we will continue to depend on, various third-party relationships in order to sustain and grow our business. We are highly dependent upon third-party technology partners for certain critical features and functionality of our platform. For example, the features available on Zendesk Talk are highly dependent on our technology integration with Twilio, Inc. Failure of this or any other technology provider to maintain, support, or secure its technology platforms in general, and our integrations in particular, or errors or defects in its technology, could materially and adversely impact our relationship with our customers, damage our reputation and brand, and harm our business and operating results. Any loss of the right to use any of this hardware or software could result in delays or difficulties in our ability to provide our products until equivalent technology is either developed by us or, if available, identified, obtained, and integrated.

For deployments of our products into complex technology environments and workflows, we are highly dependent on third-party implementation consultants to provide professional services to our customers. The failure of these third-party consultants to perform their services adequately may disrupt or damage the relationship between us and our customers, damage our brand, and harm our business.

Identifying, negotiating, and documenting relationships with strategic third parties such as technology partners and implementation providers require significant time and resources. In addition, integrating third-party technology is complex, costly, and time-consuming. Our agreements with technology partners and implementation providers are typically limited in duration, non-exclusive, and do not prohibit them from working with our competitors or from offering competing services. Our competitors may be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our products.

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

If we fail to integrate our products with a variety of operating systems, software applications, and hardware that are developed by others, our products may become less marketable, less competitive, or obsolete, and our operating results would be harmed.

Our products must integrate with a variety of network, hardware, and software platforms, and we need to continuously modify and enhance our products to adapt to changes in cloud-enabled hardware, software, networking, browser, and database technologies. In particular, we have developed our products to be able to easily integrate with third-party SaaS applications, including the applications of software providers that compete with us, through the interaction of application platform interfaces, or APIs. To date, we have not typically relied on a long-term written contract to govern our relationship with these providers. Instead, we are typically subject to the standard terms and conditions for application developers of such providers, which govern the distribution, operation, and fees of such software systems, and which are subject to change by such providers from time to time. To the extent that we do not have long-term written contracts to govern our relationship with these providers, we rely on the fact that the providers of such software systems continue to allow us access to their APIs to enable these customer integrations. Our business may be harmed if any provider of such software systems:

- discontinues or limits our access to its APIs;
- modifies its terms of service or other policies, including fees charged to, or other restrictions on us or other application developers;

- changes how customer information is accessed by us or our customers;
- establishes more favorable relationships with one or more of our competitors; or
- otherwise favors its own competitive offerings over ours.

We believe a significant component of our value proposition to customers is the ability to optimize and configure our products to communicate with these third-party SaaS applications through our respective APIs. If we are not permitted or able

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to integrate with these and other third-party SaaS applications in the future, demand for our products could be adversely impacted and business and operating results would be harmed. In addition, an increasing number of individuals within organizations are utilizing mobile devices to access the Internet and corporate resources and to conduct business. We have designed mobile applications to provide access to our products through these devices. If we cannot provide effective functionality through these mobile applications as required by organizations and individuals that widely use mobile devices, we may experience difficulty attracting and retaining customers. Failure of our products to operate effectively with future infrastructure platforms and technologies could also reduce the demand for our products, resulting in customer dissatisfaction and harm to our business. If we are unable to respond to changes in a cost-effective manner, our products may become less marketable, less competitive, or obsolete, and our operating results may be negatively impacted.

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

We may evaluate and consider potential strategic transactions, including acquisitions of, or investments in, businesses, technologies, services, products, and other assets in the future. We also may enter into relationships with other businesses to expand our products and services, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing, or investments in other companies.

Any acquisition, investment, or business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel, or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, their software is not easily adapted to work with our products, or we have difficulty retaining the customers of any acquired business due to changes in ownership, management, or otherwise. Acquisitions may also disrupt our business, divert our resources, and require significant management attention that would otherwise be available for development of our existing business. Moreover, the anticipated benefits of any acquisition, investment, or business relationship may not be realized or we may be exposed to unknown risks or liabilities.

Negotiating these transactions can be time-consuming, difficult, and expensive, and our ability to complete these transactions may often be subject to approvals that are beyond our control. Consequently, these transactions, even if announced, may not be completed. For one or more of these transactions, we may:

- issue additional equity securities that would dilute our existing stockholders;
- use cash that we may need in the future to operate our business;
- incur large charges or substantial liabilities;
- incur debt on terms unfavorable to us or that we are unable to repay;
- encounter difficulties retaining key employees of the acquired company or integrating diverse software codes or business cultures; and
- become subject to adverse tax consequences, substantial depreciation, or deferred compensation charges.

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We may be sued by third parties for alleged infringement of their proprietary rights.

There is considerable patent and other intellectual property development activity in our industry. Our future success depends in part on not infringing upon the intellectual property rights of others. From time to time, our competitors or other third parties may claim that we are infringing upon their intellectual property rights, and we may be found to be infringing upon such rights. We may receive claims from third parties, including our competitors, that our products and underlying technology infringe or violate a third party's intellectual property rights, and we may be found to be infringing upon such rights. We may be unaware of the intellectual property rights of others that may cover some or all of our technology. Any claims or litigation could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, prevent us from offering one or more of our products, or require that we comply with other unfavorable terms. We may also be obligated to indemnify our customers or business partners in connection with any such litigation and to obtain licenses, modify our products, or refund subscription fees, which could further exhaust our resources. In addition, we may incur substantial costs to resolve claims or litigation, whether or not successfully asserted against us, which could include payment of significant settlement, royalty, or license fees, modification of our products, or refunds to customers of subscription fees. Even if we were to prevail in the event of claims or litigation against us, any claim or litigation regarding our intellectual property could be costly and time-consuming and divert the attention of our management and other employees from our business operations. Such disputes could also disrupt our products, adversely impacting our customer satisfaction and ability to attract customers.

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

Our agreements with customers and other third parties may include indemnification or other provisions under which we agree to indemnify or otherwise be liable to them for losses suffered or incurred as a result of claims of intellectual property infringement, damages caused by us to property or persons, or other liabilities relating to or arising from our products or other acts or omissions. The term of these contractual provisions often survives termination or expiration of the applicable agreement. Large indemnity payments or damage claims from contractual breach could harm our business, operating results, and financial condition. From time to time, customers require us to indemnify or otherwise be liable to them for breach of confidentiality or failure to implement adequate security measures with respect to their data stored, transmitted, or processed by our products and customer service platform. Although we normally contractually limit our liability with respect to such obligations, we may still incur substantial liability related to them. Any dispute with a customer with respect to such obligations could have adverse effects on our relationship with that customer and other current and prospective customers, reduce demand for our products, and harm our business and operating results.

Our use of "open source" software could negatively affect our ability to sell our products and subject us to possible litigation.

We use open source software in our products and expect to continue to use open source software in the future. We may face claims from others claiming ownership of, or seeking to enforce the terms of, an open source license, including by demanding release of the open source software, derivative works, or our proprietary source code that was developed using such software. These claims could also result in litigation, require us to purchase a costly license, or require us to devote additional research and development resources to change our products, any of which would have a negative effect on our business and operating results. In addition, if the license terms for the open source software we utilize change, we may be forced to reengineer our products or incur additional costs. Although we have implemented policies to regulate the use and incorporation of open source software into our products, we cannot be certain that we have not incorporated open source software in our products in a manner that is inconsistent with such policies.

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

Our success and ability to compete depend in part upon our intellectual property. We currently have two issued patents and have a limited number of patent applications, none of which may result in an issued patent. We primarily rely on copyright, trade secret, and trademark laws, trade secret protection, and confidentiality or license agreements with our employees, customers, partners, and others to protect our intellectual property rights. However, the steps we take to protect our intellectual property rights may be inadequate.

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In order to protect our intellectual property rights, we may be required to spend significant resources to monitor and protect these rights. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming, and distracting to management, and could result in the impairment or loss of portions of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims, and countersuits attacking the validity and enforceability of our intellectual property rights. Our failure to secure, protect, and enforce our intellectual property rights could adversely affect our brand and adversely impact our business.

We may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs.

We have funded our operations since inception primarily through, customer payments for subscription services, the issuance of our convertible senior notes, and public and private equity financings. We do not know when or if our operations will generate sufficient cash to fund our ongoing operations. In the future, we may require additional capital to respond to business opportunities, challenges, acquisitions, a decline in the level of subscriptions for our products, or unforeseen circumstances. We may not be able to timely secure additional debt or equity financing on favorable terms, or at all. Any additional debt financing obtained by us could involve restrictive covenants relating to financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. Additionally, we may not be able to generate sufficient cash to service any debt financing obtained by us, which may force us to reduce or delay capital expenditures or sell assets or operations. If we raise additional funds through further issuances of equity, convertible debt securities, or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences, and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to grow or support our business and to respond to business challenges could be significantly limited.

We face exposure to foreign currency exchange rate fluctuations.

As our international operations expand, our exposure to the effects of fluctuations in currency exchange rates grows. While we have primarily transacted with customers in U.S. dollars historically, we expect to continue to expand the number of transactions with our customers that are denominated in foreign currencies in the future. Fluctuations in the value of the U.S. dollar and foreign currencies may make our subscriptions more expensive for international customers, which could harm our business. Additionally, we incur expenses for employee compensation and other operating expenses at our non-U.S. locations in the local currency for such locations. Fluctuations in the exchange rates between the U.S. dollar and other currencies could result in an increase to the U.S. dollar equivalent of such expenses. These fluctuations could cause our results of operations to differ from our expectations or the expectations of our investors. Additionally, such foreign currency exchange rate fluctuations could make it more difficult to detect underlying trends in our business and results of operations.

Our international subsidiaries maintain net assets that are denominated in currencies other than the functional operating currencies of these entities. Accordingly, changes in the value of foreign currencies relative to the U.S. dollar can affect our operating results due to transactional and translational remeasurements that are reflected in our results of operations. To the extent that fluctuations in foreign currency exchange rates cause our results of operations to differ from our expectations or the expectations of our investors, the trading price of our common stock could be adversely affected.

We currently operate a hedging program to mitigate the impact of foreign currency exchange rate fluctuations on our cash flows and earnings. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign currency exchange rates over the limited time the hedges are in place. Moreover, the use of hedging instruments may introduce additional risks if we are unable to structure effective hedges with such instruments, which could adversely affect our financial condition and operating results.

Taxing authorities may successfully assert that we should have collected or in the future should collect sales and use, value added, or similar taxes, and we could be subject to liability with respect to past or future sales, which could adversely affect our results of operations.

We do not collect sales and use, value added, or similar taxes in all jurisdictions in which we have sales, based on our understanding that such taxes are not applicable. Sales and use, value added, and similar tax laws and rates vary greatly by jurisdiction. Certain jurisdictions in which we do not collect such taxes may assert that such taxes are applicable, which could result in tax assessments, penalties, and interest, and we may be required to collect such taxes in the future. Such tax assessments, penalties, and interest, or future requirements, may adversely affect our results of operations.

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Our international operations subject us to potentially adverse tax consequences.
We were founded in Denmark in 2007 and were headquartered in Denmark until we reincorporated in Delaware in 2009. Today, we generally conduct our international operations through subsidiaries and report our taxable income in various jurisdictions worldwide based upon our business operations in those jurisdictions. Our intercompany relationships and transactions are subject to complex regulations, including transfer pricing regulations administered by taxing authorities in various jurisdictions. Our tax returns are generally subject to examination by taxing authorities and the relevant taxing authorities may disagree with our determinations as to the value of assets sold or acquired or income and expenses attributable to specific jurisdictions or transactions. If such a disagreement were to occur, and our position were not sustained, we could be required to pay additional taxes, interest, and penalties, which could result in one-time tax charges, higher effective tax rates, reduced cash flows, and lower overall profitability of our operations.
Additionally, tax laws are dynamic and subject to change as new laws are passed and new interpretations of the law are issued or applied. The United States recently enacted significant tax reform, and certain provisions of the new law may potentially adversely affect us in the future. In addition, governmental tax authorities are increasingly scrutinizing the tax positions of companies. Many countries in the European Union, as well as a number of other countries and organizations such as the Organization for Economic Cooperation and Development, are actively considering changes to existing tax laws that, if enacted, could increase our tax obligations in countries where we do business. If U.S. or other foreign tax authorities change applicable tax laws, our overall taxes could increase, and our business, financial condition, or results of operations may be adversely impacted.
If our goodwill or intangible assets become impaired, we may be required to record a significant charge to earnings.
We review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. As of June 30, 2018, we had a net balance of $65.6 million of goodwill and intangible assets related to prior acquisitions. An adverse change in market conditions, particularly a change resulting in a significant decrease in our share price, or if such change has the effect of changing one of our critical assumptions or estimates, could result in a change to the estimation of fair value that could result in an impairment charge to our goodwill or intangible assets. Any such charges may have a material negative impact on our operating results.
Our ability to use our net operating losses to offset future taxable income may be subject to certain limitations.
As of December 31, 2017, we had federal and state net operating loss carryforwards, or NOLs, of $464.5 million and $218.4 million, respectively, due to prior period losses. In general, under Section 382 of the Internal Revenue Code of 1986, as amended, or the Code, a corporation that undergoes an "ownership change" is subject to limitations on its ability to utilize its NOLs to offset future taxable income. Our existing NOLs may be subject to limitations arising from previous ownership changes, including in connection with our initial public offering or our follow-on public offering. Future changes in our stock ownership, some of which are outside of our control, could result in an ownership change under Section 382 of the Code. Furthermore, our ability to utilize NOLs of companies that we may acquire in the future may be subject to limitations. There is also a risk that due to regulatory changes, such as suspensions on the use of NOLs, or other unforeseen reasons, our existing NOLs could expire or otherwise be unavailable to offset future income tax liabilities. In addition, under the Tax Cuts and Jobs Act, or the Tax Act, the amount of NOLs that we are permitted to deduct in any taxable year is limited to 80% of our taxable income in such year, where taxable income is determined without regard to the NOL deduction itself. There is a risk that due to changes under the Tax Act, regulatory changes, or other unforeseen reasons, our existing NOLs could expire or otherwise be unavailable to offset future income tax liabilities. For these reasons, we may not be able to realize a tax benefit from the use of our NOLs, whether or not we attain profitability.
Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.
Generally accepted accounting principles, or GAAP, in the United States are subject to interpretation by the Financial Accounting Standards Board, or FASB, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results and could affect the reporting of transactions completed before the announcement of a change. For

example, on January 1, 2018, we adopted Accounting Standards Codification 606, “Revenue from Contracts with Customers,” which changed our accounting policies regarding revenue recognition and incremental costs to acquire contracts. We also adjusted our consolidated financial statements from amounts previously reported to reflect the adoption. Certain other standards that become effective in the future may have a material impact on our consolidated financial statements. See Note 1 of the notes to our condensed consolidated financial information for information regarding the effect of new accounting pronouncements on our consolidated financial

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statements. Any difficulties in implementing these standards could cause us to fail to meet our financial reporting obligations, which could result in regulatory discipline and harm investors' confidence in us.

Our estimates of market opportunity and forecasts of market growth may prove to be inaccurate, and even if the market in which we compete achieves the forecasted growth, our business could fail to grow at similar rates, if at all.

Market opportunity estimates and growth forecasts are subject to significant uncertainty and are based on assumptions and estimates that may not prove to be accurate. Our estimates and forecasts relating to the size and expected growth of the customer relationship management market may prove to be inaccurate. Even if the market in which we compete meets our size estimates and forecasted growth, our business could fail to grow at similar rates, if at all.

We depend and rely upon SaaS technologies from third parties to operate our business and interruptions or performance problems with these technologies may adversely affect our business and operating results.

We rely heavily on hosted SaaS applications from third parties in order to operate critical functions of our business, including billing and order management, enterprise resource planning, and financial accounting services. If these services become unavailable due to extended outages or interruptions, or because they are no longer available on commercially reasonable terms, our expenses could increase, our ability to manage finances could be interrupted, and our processes for managing sales of our products and supporting our customers could be impaired until equivalent services, if available, are identified, obtained, and implemented, all of which could adversely affect our business.

Changes in laws and regulations related to the Internet or changes in the Internet infrastructure itself may diminish the demand for our products, cause us to incur additional expenses, or otherwise have a negative impact on our business.

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication, and business applications. Federal, state, or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting the use of the Internet as a commercial medium. Changes in these laws or regulations could require us to modify our products in order to comply with these changes or substantially increase costs associated with the operation of our products. Additionally, the adoption of any laws, regulations, or practices limiting Internet neutrality could allow Internet service providers to block, degrade, or interfere with our products or services. These laws, regulations, or practices could decrease the demand for, or the usage of, our products and services, increase our cost of doing business, and adversely affect our operating results. In addition, government agencies or private organizations have imposed and may impose additional taxes, fees, or other charges for accessing the Internet or commerce conducted via the Internet. These laws or charges could limit the growth of Internet-related commerce or communications generally, or result in reductions in the demand for Internet-based platforms and services such as ours. In addition, the use of the Internet as a business tool could be adversely affected due to delays in the development or adoption of new standards and protocols to handle increased demands of Internet activity, security, reliability, cost, ease-of-use, accessibility, and quality of service. The performance of the Internet and its acceptance as a business tool has been adversely affected by "viruses," "malware," and similar malicious programs, and the Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure.

Catastrophic events may disrupt our business.

Our corporate headquarters are located in San Francisco, California and we operate in or utilize hosting resources that are located in North America, Europe, Asia, and Australia. Key features and functionality of our products are enabled by third parties that are headquartered in California and operate in or utilize data centers in the United States and Europe. Additionally, we rely on our network and third-party infrastructure and enterprise applications, internal technology systems, and our website for our development, marketing, operational support, hosted services, and sales activities. In the event of a major earthquake, hurricane, or catastrophic event such as fire, flood, power loss, telecommunications failure, cyber-attack, war, or terrorist attack, we may be unable to continue our operations and may endure system interruptions, reputational harm, delays in our application development, lengthy interruptions in our products, breaches of data security, and loss of critical data, all of which could have an adverse effect on our future operating results.

Exposure to United Kingdom political developments, including the United Kingdom's vote to leave the European Union, could have a material adverse effect on us.

On June 23, 2016, a referendum was held on the United Kingdom's membership in the European Union, the outcome of which was a vote in favor of leaving the European Union. The United Kingdom's vote to leave the European Union creates

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an uncertain political and economic environment in the United Kingdom and potentially across other European Union member states, which may last for a number of months or years.

The result of the referendum means that the long-term nature of the United Kingdom's relationship with the European Union is unclear and that there is considerable uncertainty as to when any such relationship will be agreed and implemented. In the interim, there is a risk of instability for both the United Kingdom and the European Union, which could adversely affect our results, financial condition, and prospects.

The political and economic instability created by the United Kingdom's vote to leave the European Union has caused and may continue to cause significant volatility in global financial markets and the value of the British Pound Sterling currency or other currencies, including the Euro. Depending on the terms reached regarding any exit from the European Union, it is possible that there may be adverse practical or operational implications on our business.

The outcome of the referendum has also created uncertainty with regard to the regulation of data protection in the United Kingdom. In particular, it is unclear how the United Kingdom's vote to leave the European Union will affect the United Kingdom's enactment of the European General Data Protection Regulation, and how data transfers to and from the United Kingdom will be regulated.

Risks Related to Ownership of Our Common Stock

Our stock price has been, and may continue to be, volatile or may decline regardless of our operating performance, resulting in substantial losses for our stockholders.

The trading price of our common stock has been, and may continue to be, volatile and could fluctuate widely regardless of our operating performance. The market price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our operating results;
- the financial projections we may provide to the public, any changes in these projections, or our failure to meet these projections;
- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates, and publication of other news by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- ratings changes by any securities analysts who follow our company;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures, or capital commitments;
- changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular;
- price and volume fluctuations in the overall stock market from time to time, including as a result of trends in the economy as a whole;
- changes in accounting standards, policies, guidelines, interpretations, or principles;
- actual or anticipated developments in our business or our competitors’ businesses or the competitive landscape generally;
- developments or disputes concerning our intellectual property or our products, or third-party proprietary rights;
- announced or completed acquisitions of businesses or technologies by us or our competitors;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- any major change in our board of directors or management;
- sales of shares of our common stock by us or our stockholders;
- lawsuits threatened or filed against us; and
- other events or factors, including those resulting from war, incidents of terrorism, or responses to these events.

In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from operating our business, and adversely affect our business, results of operations, financial condition, and cash flows.

Our directors, officers, and principal stockholders beneficially own a significant percentage of our stock and will be able to exert significant influence over matters subject to stockholder approval.

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As of June 30, 2018, our directors, officers, five percent or greater stockholders, and their respective affiliates beneficially owned in the aggregate approximately 38% of our outstanding common stock. As a result, these stockholders have the ability to influence us through this ownership position. These stockholders may be able to exert significant influence in matters requiring stockholder approval. For example, these stockholders may be able to exert significant influence in elections of directors, amendments of our organizational documents, and approval of any merger, sale of assets, or other major corporate transaction. This may prevent or discourage unsolicited acquisition proposals or offers for our common stock that you may feel are in your best interest as one of our stockholders.

Substantial future sales of shares of our common stock could cause the market price of our common stock to decline.

The market price of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors, executive officers, and significant stockholders, or the perception in the market that holders of a large number of shares intend to sell their shares.

Additionally, the shares of common stock subject to outstanding options and restricted stock unit awards under our equity incentive plans and the shares reserved for future issuance under our equity incentive plans will become eligible for sale in the public market in the future, subject to certain legal and contractual limitations.

Certain holders of our common stock have rights, subject to some conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or our stockholders.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of our company more difficult, limit attempts by our stockholders to replace or remove our current management, and limit the market price of our common stock.

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

- authorize our board of directors to issue, without further action by our stockholders, shares of undesignated preferred stock with terms, rights, and preferences determined by our board of directors that may be senior to our common stock;
- require that any action to be taken by our stockholders be effected at a duly called annual or special meeting and not by written consent;
- specify that special meetings of our stockholders can be called only by our board of directors, the Chair of our board of directors, or our Chief Executive Officer;
- establish an advance notice procedure for stockholder proposals to be brought before an annual meeting, including proposed nominations of persons for election to our board of directors;
- establish that our board of directors is divided into three classes, Class I, Class II, and Class III, with each class serving three-year staggered terms;
- prohibit cumulative voting in the election of directors;
- provide that our directors may be removed only for cause;
- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum; and
- require the approval of our board of directors or the holders of at least 75% of our outstanding shares of capital stock to amend our bylaws and certain provisions of our certificate of incorporation.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the General Corporation Law of the State of Delaware, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with any "interested" stockholder for a period of three years following the date on which the stockholder became an "interested" stockholder. Any delay or prevention of a change of control transaction or changes in our management could cause the market price of our common stock to decline.

The requirements of being a public company may strain our resources, divert management’s attention, and affect our ability to attract and retain executive management and qualified board members.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the listing requirements of the exchanges and other

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markets upon which our common stock is listed, and other applicable securities rules and regulations. Compliance with these rules and regulations increase our legal and financial compliance costs, make some activities more difficult, time-consuming, or costly, and increase demand on our systems and resources. The Exchange Act requires, among other things, that we file annual, quarterly, and current reports with respect to our business and operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. We are required to disclose changes made in our internal control and procedures on a quarterly basis and to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. As a result of the complexity involved in complying with the rules and regulations applicable to public companies, our management's attention may be diverted from other business concerns, which could adversely affect our business and operating results. Although we have already hired additional employees to assist us in complying with these requirements, we may need to hire more employees in the future or engage outside consultants, which will increase our operating expenses.

In addition, changing laws, regulations, and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs, and making some activities more time consuming. These laws, regulations, and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest substantial resources to comply with evolving laws, regulations, and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from business operations to compliance activities. If our efforts to comply with new laws, regulations, and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us and our business may be adversely affected.

Being a public company and these new rules and regulations have made it more expensive for us to obtain director and officer liability insurance, and in the future we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee and compensation committee, and qualified executive officers.

As a result of disclosure of information in our filings with the SEC, our business and financial condition have become more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business and operating results could be adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business and operating results.

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

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

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

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

Our charter documents designate the Court of Chancery of the State of Delaware as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers, or other employees.

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Our certificate of incorporation and bylaws provide that, unless we consent in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (A) any derivative action or proceeding brought on our behalf, (B) any action asserting a claim of breach of a fiduciary duty owed by any of our directors, officers, or other employees to us or our stockholders, (C) any action asserting a claim arising pursuant to any provision of the General Corporation Law of the State of Delaware, our certificate of incorporation, or our bylaws, or (D) any action asserting a claim against us governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of our capital stock shall be deemed to have notice of and consented to the provisions of our certificate of incorporation described above. This choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers, or other employees, which may discourage such lawsuits against us and our directors, officers, and other employees. Alternatively, if a court were to find these provisions of our certificate of incorporation inapplicable to, or unenforceable in respect of, one or more of the specified types of actions or proceedings, we may incur additional costs associated with resolving such matters in other jurisdictions, which could adversely affect our business, financial condition, or results of operations.

Risks Related to our Outstanding Convertible Notes

Servicing our debt may require a significant amount of cash. We may not have sufficient cash flow from our business to pay our indebtedness, and we may not have the ability to raise the funds necessary to settle for cash conversions of the Notes or to repurchase the Notes for cash upon a fundamental change, which could adversely affect our business and results of operations.

In March 2018, we issued $575 million in aggregate principal amount of 0.25% convertible senior notes due 2023, or Notes, in a private offering. The interest rate is fixed at 0.25% per annum and is payable semi-annually in arrears on March 15 and September 15 of each year, beginning on September 15, 2018. Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not generate cash flows from operations in the future that are sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flows, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional debt financing or equity capital on terms that may be onerous or highly dilutive. Our ability to refinance any future indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations.

Holders of the Notes have the right to require us to repurchase their notes upon the occurrence of a fundamental change (as defined in the indenture governing the Notes) at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any. Upon conversion, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the notes being converted. We may not have enough available cash or be able to obtain financing at the time we are required to make repurchases in connection with such conversion and our ability to pay may additionally be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to repurchase the Notes at a time when the repurchase is required by the indenture governing the notes or to pay any cash payable on future conversions as required by such indenture would constitute a default under such indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or make cash payments upon conversions thereof.

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

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

Transactions relating to our Notes may affect the value of our common stock.

The conversion of some or all of the Notes would dilute the ownership interests of existing stockholders to the extent we satisfy our conversion obligation by delivering shares of our common stock upon any conversion of such Notes. Our Notes may become in the future convertible at the option of their holders under certain circumstances. If holders of our Notes elect to convert

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their notes, we may settle our conversion obligation by delivering to them a significant number of shares of our common stock, which would cause dilution to our existing stockholders.

In addition, in connection with the issuance of the Notes, we entered into capped call transactions with certain financial institutions, or the Option Counterparties. The capped call transactions are expected generally to reduce the potential dilution to our common stock upon any conversion or settlement of the Notes and/or offset any cash payments we are required to make in excess of the principal amount of converted Notes, as the case may be, with such reduction and/or offset subject to a cap. From time to time, the Option Counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivative transactions with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions prior to the maturity of the Notes. This activity could cause a decrease in the market price of our common stock.

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

Under Financial Accounting Standards Board Accounting Standards Codification 470-20, Debt with Conversion and Other Options, or ASC 470-20, an entity must separately account for the liability and equity components of convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer’s economic interest cost. ASC 470-20 requires the value of the conversion option of the Notes, representing the equity component, to be recorded as additional paid-in capital within stockholders’ equity in our consolidated balance sheet and as a discount to the Notes, which reduces their initial carrying value. The carrying value of the Notes, net of the discount recorded, will be accreted up to the principal amount of the Notes from the issuance date until maturity, which will result in non-cash charges to interest expense in our consolidated statement of operations. Accordingly, we will report lower net income or higher net loss in our financial results because ASC 470-20 requires interest to include both the current period’s accretion of the debt discount and the instrument’s coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the Notes.

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

Item 6. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

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EXHIBIT
INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
10.1#	Amended and Restated Non-Employee Director Compensation Policy.	8-K	001-36456	10.1	May 1, 2018
10.2	Lease Agreement by and between Marlin Cove, Inc. and SF Prosperity 1, LLC, as tenants in common, and Zendesk, Inc., dated June 22, 2018.	Filed herewith			
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.	Filed herewith			
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.	Filed herewith			
32.1*	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.	Furnished herewith			
101.INS	XBRL Instance Document	Filed herewith			
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith			

# Indicates management contract or compensatory plan, contract, or agreement.

* The certifications furnished in Exhibit 32.1 hereto are deemed to accompany this Quarterly Report on Form 10-Q and will not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, except to the extent that the Registrant specifically incorporates it by reference.

SIGNATURES

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

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	Zendesk, Inc.
Date: August 2, 2018	By: /s/ Elena Gomez
	Elena Gomez
	Chief Financial Officer
	(Principal Financial and Accounting Officer)