ServiceNow, Inc.
Form 10-Q
August 03, 2016

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

FORM 10-Q

x Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2016
OR
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-35580

SERVICENOW, INC.
(Exact name of registrant as specified in its charter)

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

ServiceNow, Inc.
2225 Lawson Lane
Santa Clara, California 95054
(408) 501-8550
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes 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 or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x
As of June 30, 2016, there were approximately 164.5 million shares of the Registrant’s Common Stock outstanding.

TABLE OF CONTENTS

		Page
	PART I	
Item 1.	Financial Statements	1
	Condensed Consolidated Balance Sheets as of June 30, 2016 (Unaudited) and December 31, 2015	1
	Condensed Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)	2
	Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2016 and 2015 (Unaudited)	3
	Notes to Condensed Consolidated Financial Statements (Unaudited)	4
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	37
Item 4.	Controls and Procedures	37
	PART II	
Item 1.	Legal Proceedings	39
Item 1A.	Risk Factors	39
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	58
Item 3.	Defaults Upon Senior Securities	58
Item 4.	Mine Safety Disclosures	58
Item 5.	Other Information	58
Item 6.	Exhibits	58
	Signatures	

PART I

ITEM 1. FINANCIAL STATEMENTS

SERVICENOW, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$289,113	$412,305
Short-term investments	517,601	388,945
Accounts receivable, net	197,296	203,333
Current portion of deferred commissions	57,232	51,976
Prepaid expenses and other current assets	36,647	29,076
Total current assets	1,097,889	1,085,635
Deferred commissions, less current portion	39,716	33,016
Long-term investments	224,439	422,667
Property and equipment, net	166,551	144,714
Intangible assets, net	64,873	43,005
Goodwill	83,115	55,669
Other assets	37,755	22,346
Total assets	$1,714,338	$1,807,052
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$41,095	$37,369
Accrued expenses and other current liabilities	113,131	101,264
Current portion of deferred revenue	697,855	593,003
Total current liabilities	852,081	731,636
Deferred revenue, less current portion	15,130	10,751
Convertible senior notes, net	490,891	474,534
Other long-term liabilities	31,954	23,317
Total liabilities	1,390,056	1,240,238
Stockholders' equity:		
Common stock	164	160
Additional paid-in capital	1,268,714	1,140,545
Accumulated other comprehensive loss	(16,053)	(16,882)
Accumulated deficit	(928,543)	(557,009)
Total stockholders' equity	324,282	566,814
Total liabilities and stockholders' equity	$1,714,338	$1,807,052

See accompanying notes to condensed consolidated financial statements

SERVICENOW, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)
(in thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues:				
Subscription	$290,679	$200,461	$558,101	$380,368
Professional services and other	50,633	46,255	89,090	78,312
Total revenues	341,312	246,716	647,191	458,680
Cost of revenues[(1)]:				
Subscription	56,360	45,392	109,141	87,836
Professional services and other	40,289	34,325	81,768	68,780
Total cost of revenues	96,649	79,717	190,909	156,616
Gross profit	244,663	166,999	456,282	302,064
Operating expenses[(1)]:				
Sales and marketing	186,506	136,574	345,116	246,631
Research and development	70,364	53,276	136,288	103,124
General and administrative	36,071	30,384	77,308	59,776
Legal settlements	—	—	270,000	—
Total operating expenses	292,941	220,234	828,712	409,531
Loss from operations	(48,278)	(53,235)	(372,430)	(107,467)
Interest expense	(8,248)	(7,707)	(16,357)	(15,285)
Interest and other income (expense), net	2,260	521	2,962	5,225
Loss before income taxes	(54,266)	(60,421)	(385,825)	(117,527)
Provision for (benefit from) income taxes	(4,641)	1,504	(2,868)	2,491
Net loss	$(49,625)	$(61,925)	$(382,957)	$(120,018)
Net loss per share - basic and diluted	$(0.30)	$(0.40)	$(2.35)	$(0.78)
Weighted-average shares used to compute net loss per share - basic and diluted	163,838,755	154,465,367	162,952,721	153,041,433
Other comprehensive gain (loss):				
Foreign currency translation adjustments	$(1,989)	$3,720	$(1,309)	$(339)
Unrealized gain (loss) on investments, net of tax	505	(314)	2,138	180
Other comprehensive gain (loss), net of tax	(1,484)	3,406	829	(159)
Comprehensive loss	$(51,109)	$(58,519)	$(382,128)	$(120,177)

(1) Includes stock-based compensation as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Cost of revenues:				
Subscription	$6,951	$6,067	$13,558	$11,232
Professional services and other	6,136	5,771	12,895	10,984
Sales and marketing	32,861	26,105	63,859	48,679
Research and development	21,047	17,935	41,580	33,573
General and administrative	11,070	10,468	21,481	19,952
Total stock-based compensation	$78,065	$66,346	$153,373	$124,420

See accompanying notes to condensed consolidated financial statements

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

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(382,957)	$(120,018)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	37,452	28,857
Amortization of premiums on investments	2,799	3,612
Amortization of deferred commissions	36,957	31,281
Amortization of debt discount and issuance costs	16,357	15,285
Stock-based compensation	153,373	124,420
Deferred income tax	(6,426)	—
Other	532	(4,240)
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	6,967	11,339
Deferred commissions	(48,397)	(32,832)
Prepaid expenses and other assets	(10,001)	(8,026)
Accounts payable	(272)	1,634
Deferred revenue	104,399	90,557
Accrued expenses and other liabilities	19,733	5,682
Net cash (used in) provided by operating activities(1)	(69,484)	147,551
Cash flows from investing activities:		
Purchases of property and equipment	(52,929)	(41,820)
Business combinations, net of cash acquired	(34,297)	(1,100)
Purchases of other intangibles	(14,850)	—
Purchases of investments	(180,365)	(331,496)
Purchase of strategic investment	—	(10,000)
Sales of investments	92,885	138,362
Maturities of investments	158,520	146,660
Restricted cash	(611)	66
Net cash used in investing activities	(31,647)	(99,328)
Cash flows from financing activities:		
Deferred payments on purchase of other intangibles	4,100	—
Proceeds from employee stock plans	34,151	41,684
Taxes paid related to net share settlement of equity awards	(59,786)	(12,446)
Payments on financing obligation	(223)	—
Net cash (used in) provided by financing activities(1)	(21,758)	29,238
Foreign currency effect on cash and cash equivalents	(303)	(4,562)
Net (decrease) increase in cash and cash equivalents	(123,192)	72,899
Cash and cash equivalents at beginning of period	412,305	252,455
Cash and cash equivalents at end of period	$289,113	$325,354
Supplemental disclosures of non-cash investing activities:		
Property and equipment included in accounts payable and accrued expenses	$14,058	$13,382

(1) During the six months ended June 30, 2016, we early adopted Accounting Standards Update 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting."

Refer to Note 2 Recent Accounting Pronouncements for further details. This resulted in a $0.6 million increase in net cash provided by operating activities and a corresponding $0.6 million decrease in net cash provided by financing activities for the six months ended June 30, 2015.

See accompanying notes to condensed consolidated financial statements

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

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

(1) Description of the Business

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

(2) Summary of Significant Accounting Policies

Basis of Presentation

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

Principles of Consolidation

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

Prior Period Reclassification

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

Use of Estimates

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

Warranties and Indemnification

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

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

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

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

Recent Accounting Pronouncements

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

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

- The standard eliminates additional paid in capital (APIC) pools and requires excess tax benefits and tax deficiencies to be recorded in the income statement as a discrete item when the awards vest or are settled. The adoption of this guidance on a prospective basis resulted in the recognition of excess tax benefits in our provision for income taxes of $1.7 million for the three and six months ended June 30, 2016.

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

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

- We elected to apply the statement of cash flows guidance that cash flows related to excess tax benefits be presented as an operating activity retrospectively, which resulted in a $0.6 million increase to net cash provided by operating activities and a corresponding decrease to net cash provided by financing activities in the accompanying condensed consolidated statement of cash flows for the six months ended June 30, 2015, as compared to the amounts previously reported.

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

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets, and to recognize on the income statement the expenses in a manner similar to current practice. This new standard is effective for our interim and annual periods beginning January 1, 2019 and early adoption is permitted. While we are currently evaluating the impact of this standard on our condensed consolidated financial statements, we anticipate this standard will have a material impact on our condensed consolidated balance sheets given that we have operating lease commitments of approximately $280 million as of June 30, 2016. However, we do not anticipate this standard will have a material impact on our condensed consolidated statements of comprehensive loss since the expense recognition under this new standard will be similar to current practice.

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

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

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

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which will supersede virtually all existing revenue guidance. Under this standard, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This standard should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in the retained earnings. In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the principal versus agent guidance in the new revenue recognition standard. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which clarifies the guidance on accounting for licenses of intellectual property (IP) and identifying performance obligations in the new revenue recognition standard. In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," which amended the revenue recognition guidance regarding collectability, non-cash consideration, presentation of sales tax and transition. These new standards are effective for our interim and annual periods beginning January 1, 2018 and early adoption beginning January 1, 2017 is permitted. We are currently evaluating the impact of these standards on our condensed consolidated financial statements.

(3) Investments

Marketable Securities

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

June 30, 2016

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Commercial paper	$30,000	$ —	$ —	$30,000
Corporate notes and bonds	613,680	1,014	(131)	614,563
Certificates of deposit	14,467	—	—	14,467
U.S. government agency securities	82,945	67	(2)	83,010
Total available-for-sale securities	$741,092	$ 1,081	$ (133)	$742,040

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

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

	June 30, 2016
Due in 1 year or less	$517,601
Due in 1 year through 2 years	224,439
Total	$742,040

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

	June 30, 2016					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate notes and bonds	$201,213	$ (130)	$1,099	$ (1)	$202,312	$ (131)
U.S. government agency securities	13,058	(2)	—	—	13,058	(2)
Total	$214,271	$ (132)	$1,099	$ (1)	$215,370	$ (133)

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

Strategic Investments

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

(4) Fair Value Measurements

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

	Level 1	Level 2	Total
Cash equivalents:			
Money market funds	$100,329	$—	$100,329
Short-term investments:			
Commercial paper	—	30,000	30,000
Corporate notes and bonds	—	416,099	416,099
Certificates of deposit	—	9,362	9,362
U.S. government agency securities	—	62,140	62,140
Long-term investments:			
Corporate notes and bonds	—	198,464	198,464
Certificates of deposit	—	5,105	5,105
U.S. government agency securities	—	20,870	20,870
Total	$100,329	$742,040	$842,369

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

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

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

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

(5) Business Combinations

BrightPoint Security

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

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

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

ITapp

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

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

For both business combinations, the excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. We believe the goodwill represents the synergies expected from expanded market opportunities when integrating the acquired technologies with our offerings. The goodwill balance for both business combinations is not deductible for income tax purposes. Acquisition-related costs of $0.9 million are included in general and administrative expenses in our consolidated statements of comprehensive loss.

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

(6) Goodwill and Intangible Assets

Goodwill balances are presented below (in thousands):

	Carrying Amount
Balance as of December 31, 2015	$55,669
Goodwill acquired	26,695
Foreign currency translation adjustments	751
Balance as of June 30, 2016	$83,115

Intangible assets consist of the following (in thousands):

	June 30, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$80,265	$ (23,665)	$56,600
Other	9,275	(1,002)	8,273
Total intangible assets	$89,540	$ (24,667)	$64,873

	December 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$58,144	$ (17,463)	$40,681
Other	3,695	(1,371)	2,324
Total intangible assets	$61,839	$ (18,834)	$43,005

Amortization expense for intangible assets for the three months ended June 30, 2016 and 2015 was approximately $3.7 million and $2.9 million, respectively, and for the six months ended June 30, 2016 and 2015 was approximately $6.6 million and $5.9 million, respectively.

(7) Property and Equipment

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

	June 30, 2016	December 31, 2015
Computer equipment and software	$221,631	$180,197
Leasehold improvements	33,853	31,659
Furniture and fixtures	28,972	26,017
Building	6,404	6,318
Construction in progress	2,626	1,886
	293,486	246,077
Less: Accumulated depreciation	(126,935)	(101,363)
Total property and equipment, net	$166,551	$144,714

Construction in progress consists primarily of leasehold improvements and in-process software development costs. Depreciation expense for the three months ended June 30, 2016 and 2015 was $16.3 million and $12.1 million, respectively, and for the six months ended June 30, 2016 and 2015 was $30.8 million and $22.9 million, respectively.

10

(8) Accrued Expenses and Other Current Liabilities

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

	June 30, 2016	December 31, 2015
Taxes payable	$9,840	$9,080
Bonuses and commissions	37,678	33,124
Accrued compensation	19,442	17,089
Other employee related liabilities	22,086	21,529
Other	24,085	20,442
Total accrued expenses and other current liabilities	$113,131	$101,264

(9) Convertible Senior Notes

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

The Notes are unsecured obligations and do not contain any financial covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. Upon conversion, we may choose to pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock. We intend to settle the principal amount of the Notes with cash. The Notes are convertible up to 7.8 million shares of our common stock at an initial conversion rate of approximately 13.54 shares of common stock per $1,000 principal amount, which is equal to an initial conversion price of approximately $73.88 per share of common stock, subject to adjustment. Holders of the Notes may convert their Notes at their option at any time prior to the close of business on the business day immediately preceding July 1, 2018, only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on March 31, 2014 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

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

- upon the occurrence of specified corporate events.

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

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

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

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

	June 30, 2016	December 31, 2015
Liability:		
Principal	$575,000	$575,000
Less: debt issuance cost and debt discount, net of amortization	(84,109)	(100,466)
Net carrying amount	$490,891	$474,534

We consider the fair value of the Notes at June 30, 2016 and December 31, 2015 to be a Level 2 measurement. The estimated fair values of the Notes were $640.6 million and $741.8 million at June 30, 2016 and December 31, 2015, respectively (based on the closing trading price per $100 of the Notes on June 30, 2016 and December 31, 2015, respectively). The Notes were not convertible as of June 30, 2016 and December 31, 2015.

As of June 30, 2016, the remaining life of the Notes is 28 months. The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Amortization of debt issuance cost	$442	$413	$877	$820
Amortization of debt discount	7,806	7,294	15,480	14,465
Total	$8,248	$7,707	$16,357	$15,285
Effective interest rate of the liability component	6.5%			

Note Hedge

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

Warrants

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

(10) Accumulated Other Comprehensive Loss

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

	June 30, 2016	December 31, 2015
Foreign currency translation adjustment	$(15,747)	$(14,438)
Net unrealized loss on investments, net of tax	(306)	(2,444)
Accumulated other comprehensive loss	$(16,053)	$(16,882)

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

(11) Stockholders' Equity

Common Stock

We were authorized to issue 600,000,000 shares of common stock as of June 30, 2016. Holders of our common stock are not entitled to receive dividends unless declared by our board of directors. As of June 30, 2016, we had 164,496,689 shares of common stock outstanding and had reserved shares of common stock for future issuance as follows:

	June 30, 2016
Stock option plans:	
Options outstanding	6,902,902
RSUs	13,274,438
Stock awards available for future grants:	
2012 Equity Incentive Plan[1]	21,414,823
2012 Employee Stock Purchase Plan[1]	8,850,836
Total reserved shares of common stock for future issuance	50,442,999

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

During the six months ended June 30, 2016 and 2015, we issued a total of 3,710,925 shares and 6,034,044 shares, respectively, from stock option exercises, vesting of restricted stock units, or RSUs, and purchases from the employee stock purchase plan, or ESPP.

(12) Stock Awards

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

Our 2012 Equity Incentive Plan, or 2012 Plan, provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, RSUs, performance-based stock awards and other forms of equity compensation, or collectively, stock awards. In addition, the 2012 Plan provides for the grant of performance cash awards. Incentive stock options may be granted only to employees. All other awards may be granted to employees, including officers, as well as directors and consultants. The share reserve may increase to the extent outstanding stock options under the

2005 Plan expire or terminate unexercised. The share reserve also automatically increases on January 1 of each year until January 1, 2022, by up to 5% of the total number of shares of common stock outstanding on December 31 of the preceding year as determined by the board of directors. On January 1, 2016, 8,039,288 shares of common stock were automatically added to the 2012 Plan pursuant to the provision described in the preceding sentence.

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

Stock Options

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

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	8,255,554	$ 16.65		
Granted	169,400	65.92		
Exercised	(579,504)	5.28		$ 35,876
Canceled	(126,735)	58.05		
Outstanding at March 31, 2016	7,718,715	17.90		
Granted	131,835	68.36		
Exercised	(828,327)	17.18		$ 43,757
Canceled	(119,321)	52.26		
Outstanding at June 30, 2016	6,902,902	$ 18.36	5.73	$ 335,012
Vested and expected to vest as of June 30, 2016	6,802,214	$ 17.66	5.68	$ 334,577
Vested and exercisable as of June 30, 2016	5,863,745	$ 11.27	5.25	$ 323,962

Aggregate intrinsic value represents the difference between the estimated fair value of our common stock and the exercise price of outstanding, in-the-money options. The weighted-average grant date fair value per share of options granted was $27.06 for the six months ended June 30, 2016. The total fair value of stock options vested during the six months ended June 30, 2016 was $10.7 million.

As of June 30, 2016, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options was approximately $22.3 million. The weighted-average remaining vesting period of unvested stock options at June 30, 2016 was 2.54 years.

RSUs

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

	Number of Shares	Weighted Average Grant Date Fair Value (Per Share)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	12,417,805	$ 63.38	
Granted	3,822,832	51.11	
Vested	(1,708,179)	58.42	$ 89,516
Forfeited	(370,545)	64.43	
Outstanding at March 31, 2016	14,161,913	60.64	
Granted	805,680	67.75	
Vested	(1,285,704)	53.70	$ 86,693
Forfeited	(407,451)	63.31	
Non-vested and outstanding at June 30, 2016	13,274,438	$ 61.66	$ 881,423
Expected to vest as of June 30, 2016	11,055,763		$ 734,103

RSUs granted under the 2005 Plan and the 2012 Plan to employees generally vest over a four-year period. As of June 30, 2016, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested RSUs was approximately $605.1 million and the weighted-average remaining vesting period was 2.87 years.

(13) Net Loss Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator:				
Net loss	$(49,625)	$ (61,925)	$(382,957)	$(120,018)
Denominator:				
Weighted-average shares outstanding—basic and diluted	163,838,755	154,465,367	162,952,721	153,041,433
Net loss per share—basic and diluted:	$(0.30)	$ (0.40)	$(2.35)	$(0.78)

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

	June 30,	
	2016	2015
Common stock options	6,902,902	12,017,564
Restricted stock units	13,274,438	13,079,988
Common stock subject to repurchase	—	21
ESPP obligations	288,467	196,836
Convertible senior notes	7,783,023	7,783,023
Warrants related to the issuance of convertible senior notes	7,783,023	7,783,023

Total potentially dilutive securities	36,031,853	40,860,455

(14) Income Taxes

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

Our effective tax rate was 9% and 1% for the three and six months ended June 30, 2016, respectively, which was lower than the U.S. federal statutory tax rate of 34%. The lower tax rate was primarily attributable to our loss from operations, the foreign tax rate differential, a release of the valuation allowance in connection with acquisitions and tax effects of stock option excess tax benefits from the early adoption of ASU 2016-09.

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

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

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

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

(15) Commitments and Contingencies

Leases

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

Legal Proceedings

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

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

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

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

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

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

(16) Information about Geographic Areas and Products

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
North America (1)	$234,009	$174,387	$444,526	$323,033
EMEA (2)	82,065	55,803	156,346	104,333
Asia Pacific and other	25,238	16,526	46,319	31,314
Total revenues	$341,312	$246,716	$647,191	$458,680

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

	June 30,	December 31,
	2016	2015
North America(3)	$120,909	$104,085
EMEA(2)	33,665	32,027
Asia Pacific and other	11,977	8,602
Total property and equipment, net	$166,551	$144,714

(1) Revenues attributed to the United States were approximately 95% of North America revenues for the three months ended June 30, 2016 and 2015, and 95% and 94% for the six months ended June 30, 2016 and 2015, respectively.

(2) Europe, the Middle East and Africa

(3) Property and equipment, net attributed to the United States were approximately 97% and 98% of property and equipment, net attributable to North America as of June 30, 2016 and December 31, 2015, respectively.

Subscription revenues consist of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Enterprise Service Management solutions	$264,667	$186,082	$510,529	$353,286

IT Operations Management solutions	26,012	14,379	47,572	27,082
Total subscription revenues	$290,679	$200,461	$558,101	$380,368

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

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

The following discussion and analysis of our financial condition, results of operations and cash flows should be read in conjunction with the (1) unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q, and (2) the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2015 included in the Annual Report on Form 10-K dated as of, and filed with the Securities and Exchange Commission, or the SEC, on February 25, 2016 (File No. 001-35580). This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and similar expressions or variations. Such forward-lookin statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled "Risk Factors," set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our other SEC filings. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

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

Overview

ServiceNow is a leading provider of enterprise cloud computing solutions that define, structure, manage and automate services across the global enterprise. Our mission is to help the modern enterprise operate faster and be more scalable by applying a service-oriented lens to the activities, tasks and processes that comprise day-to-day work life. We offer our services on an annual subscription fee basis which includes access to the ordered subscription service and related support including updates to the subscribed service during the subscription term. We provide a scaled pricing model based on the duration of the subscription term and we frequently extend discounts to our customers based on the number of users. We generate sales through our direct sales team and indirectly through channel partners and third-party referrals. We also generate revenues from professional services for implementation and training of customer personnel. We generally bill our customers annually in advance for subscription services and monthly in arrears for our professional services as the work is performed.

A majority of our revenues come from large global enterprise customers. We continue to invest in the development of our services, infrastructure and sales and marketing to drive long-term growth. We increased our overall employee headcount to 4,241 as of June 30, 2016 from 3,187 as of June 30, 2015.

Key Factors Affecting Our Performance

Number of customers with ACV greater than $1 million. We count the total number of customers with annualized contract value, or ACV greater than $1 million as of the end of the period. We had 272 and 187 customers with ACV greater than $1 million as of June 30, 2016 and 2015, respectively. For purposes of customer count, a customer is defined as an entity with a unique Dunn & Bradstreet Global Ultimate, or GULT, Data Universal Numbering System, or DUNS, and an active subscription contract as of the measurement date. The DUNS number is a global standard for business identification and tracking. We will make exceptions for holding companies, government entities and other organizations for which the GULT, in our judgment, does not accurately represent the ServiceNow customer. For example, while all U.S. government agencies roll up to "Government of the United States" under the GULT, we count each government agency that we contract with as a separate customer. Our customer count is subject to adjustments for acquisitions, spin-offs and other market activity. Previously disclosed number of customers with ACV greater than $1 million as well as our average contract term calculations are restated to allow for comparability.

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

Our G2K customer count based on the most recent Forbes Global 2000 list and adjusted for acquisitions, spin-offs and other market activity was 681 and 577 as of June 30, 2016 and 2015, respectively.

Average ACV per G2K customer. We calculate average ACV for our G2K customers by taking cumulative ACV from G2K customers as of the end of the period divided by cumulative count of G2K customers as of the end of the period. Our average ACV per G2K customer was approximately $941,000 and $808,000 as of June 30, 2016 and 2015, respectively.

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

Billings. We define billings as revenue recognized plus the change in total deferred revenue as presented on the condensed consolidated statements of cash flows. The change in total deferred revenue as presented on the condensed consolidated statements of cash flows represent the change in deferred revenues in local currencies translated into U.S. dollars using an average foreign currency exchange rate, and aligns actual billings with the exchange rates in effect at the time of the billings. We believe billings offers investors useful supplemental information regarding the performance of our business and will help investors better understand the sales volume and performance of our business.

A calculation of billings is provided below:

	Three Months Ended June 30,		% Change	Six Months Ended June 30,		% Change
	2016	2015		2016	2015	
	(dollars in thousands)			(dollars in thousands)		
Billings:						
Total revenues	$341,312	$246,716	38 %	$647,191	$458,680	41 %
Change in deferred revenue from the condensed consolidated statements of cash flows	33,596	34,696	(3)%	104,399	90,557	15 %
Total billings	$374,908	$281,412	33 %	$751,590	$549,237	37 %

While our international operations provide a significant portion of our total billings and revenues, foreign exchange rate fluctuations did not significantly impact our actual year-over-year billings growth.

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

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Free cash flow:			
Net cash (used in) provided by operating activities	$(69,484)	$147,551	(147)%
Purchases of property and equipment	(52,929)	(41,820)	27 %
Free cash flow [(1)]	$(122,413)	$105,731	(216)%

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

Average contract term. We calculate the average contract term for new customers, upsells and renewals based on the term of those contracts entered into during the period weighted by their ACV. The average new customer contract term was 31 months and 32 months for the three months ended June 30, 2016 and 2015, respectively, and 32 months and 31 months for the six months ended June 30, 2016 and 2015, respectively. The average upsell contract term was 28 months and 26 months for the three months ended June 30, 2016 and 2015, respectively, and 25 months and 24 months for the six months ended June 30, 2016 and 2015, respectively. The average renewal contract term was 26 months and 24 months for the three months ended June 30, 2016 and 2015, respectively, and 27 months and 25 months for the six months ended June 30, 2016 and 2015, respectively.

Components of Results of Operations

Revenues

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

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

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

Allocation of Overhead Costs

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

Cost of Revenues

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

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

Professional services associated with the implementation and configuration of our subscription services are performed directly by our services team, as well as by contracted third-party partners. Fees paid to third-party partners are primarily recognized as cost of revenues as the professional services are delivered. Cost of revenues associated with our professional services engagements contracted with third-party partners as a percentage of professional services and other revenues was 15% in each of the three months ended June 30, 2016 and 2015, and 17% for each of the six months ended June 30, 2016 and 2015.

Sales and Marketing

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

Research and Development

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

General and Administrative

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

Legal Settlements

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

Provision for Income Taxes

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

Recent Accounting Pronouncements

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

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

- The standard eliminates additional paid in capital (APIC) pools and requires excess tax benefits and tax deficiencies to be recorded in the income statement as a discrete item when the awards vest or are settled. The adoption of this guidance on a prospective basis resulted in the recognition of excess tax benefits in our provision for income taxes of $1.7 million for the three and six months ended June 30, 2016.

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

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

- We elected to apply the statement of cash flows guidance that cash flows related to excess tax benefits be presented as an operating activity retrospectively, which resulted in a $0.6 million increase to net cash provided by operating activities and a corresponding decrease to net cash provided by financing activities in the accompanying condensed consolidated statement of cash flows for the six months ended June 30, 2015, as compared to the amounts previously reported.

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

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets, and to recognize on the income statement the expenses in a manner similar to current practice. This new standard is effective for our interim and annual periods beginning January 1, 2019 and early adoption is permitted. While we are currently evaluating the impact of this standard on our condensed consolidated financial statements, we anticipate this standard will have a material impact on our condensed consolidated balance sheets given that we have operating lease commitments of approximately $280 million as of June 30, 2016. However, we do not anticipate this standard will have a material impact on our condensed consolidated statements of comprehensive loss since the expense recognition under this new standard will be similar to current practice.

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

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

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

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which will supersede virtually all existing revenue guidance. Under this standard, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This standard should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in the retained earnings. In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the principal versus agent guidance in the new revenue recognition standard. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which clarifies the guidance on accounting for licenses of intellectual property (IP) and identifying performance obligations in the new revenue recognition standard. In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," which amended the revenue recognition guidance regarding collectability, non-cash consideration, presentation of sales tax and transition. These new standards are effective for our interim and annual periods beginning January 1, 2018 and early adoption beginning January 1, 2017 is permitted. We are currently evaluating the impact of these standards on our condensed consolidated financial statements.

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Revenues:				
Subscription	$290,679	$200,461	$558,101	$380,368
Professional services and other	50,633	46,255	89,090	78,312
Total revenues	341,312	246,716	647,191	458,680
Cost of revenues(1):				
Subscription	56,360	45,392	109,141	87,836
Professional services and other	40,289	34,325	81,768	68,780
Total cost of revenues	96,649	79,717	190,909	156,616
Gross profit	244,663	166,999	456,282	302,064
Operating expenses(1):				
Sales and marketing	186,506	136,574	345,116	246,631
Research and development	70,364	53,276	136,288	103,124
General and administrative	36,071	30,384	77,308	59,776
Legal settlements	—	—	270,000	—
Total operating expenses	292,941	220,234	828,712	409,531
Loss from operations	(48,278)	(53,235)	(372,430)	(107,467)
Interest expense	(8,248)	(7,707)	(16,357)	(15,285)
Interest income and other income (expense), net	2,260	521	2,962	5,225
Loss before income taxes	(54,266)	(60,421)	(385,825)	(117,527)
Provision for (benefit from) income taxes	(4,641)	1,504	(2,868)	2,491
Net loss	$(49,625)	$(61,925)	$(382,957)	$(120,018)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Cost of revenues:				
Subscription	$6,951	$6,067	$13,558	$11,232
Professional services and other	6,136	5,771	12,895	10,984
Sales and marketing	32,861	26,105	63,859	48,679
Research and development	21,047	17,935	41,580	33,573
General and administrative	11,070	10,468	21,481	19,952
Total stock-based compensation	$78,065	$66,346	$153,373	$124,420

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues:				
Subscription	85 %	81 %	86 %	83 %
Professional services and other	15	19	14	17
Total revenues	100	100	100	100
Cost of revenues:				
Subscription	17	18	17	19
Professional services and other	12	14	13	15
Total cost of revenues	29	32	30	34
Gross profit	71	68	70	66
Operating expenses:				
Sales and marketing	55	55	53	54
Research and development	21	22	21	22
General and administrative	11	12	12	13
Legal settlements	—	—	42	—
Total operating expenses	87	89	128	89
Loss from operations	(16)	(21)	(58)	(23)
Interest expense	(2)	(3)	(3)	(2)
Interest income and other income (expense), net	1	—	—	—
Loss before income taxes	(17)	(24)	(61)	(25)
Provision for (benefit from) income taxes	(1)	1	—	1
Net loss	(16)%	(25)%	(61)%	(26)%

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Revenues by geography				
North America	$234,009	$174,387	$444,526	$323,033
EMEA [(1)]	82,065	55,803	156,346	104,333
Asia Pacific and other	25,238	16,526	46,319	31,314
Total revenues	$341,312	$246,716	$647,191	$458,680

(1) Europe, the Middle East and Africa

Comparison of the Three Months Ended June 30, 2016 and 2015

Revenues

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Revenues:			
Subscription	$290,679	$200,461	45 %
Professional services and other	50,633	46,255	9 %
Total revenues	$341,312	$246,716	38 %
Percentage of revenues:			
Subscription	85 %	81 %	
Professional services and other	15 %	19 %	
Total	100 %	100 %	

Subscription revenues increased $90.2 million during the three months ended June 30, 2016, compared to the same period in the prior year, driven by our upsells and an increase in our customer count.

Subscription revenues consist of the following:

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Enterprise Service Management solutions	$264,667	$186,082	42 %
IT Operations Management solutions	26,012	14,379	81 %
Total subscription revenues	$290,679	$200,461	45 %

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

Professional services and other revenues increased $4.4 million during the three months ended June 30, 2016, compared to the same period in the prior year, due to an increase in the services provided to our growing customer base. In addition, revenues from our annual Knowledge user conference increased to $12.8 million for the three months ended June 30, 2016 from $10.9 million for the three months ended June 30, 2015 due to increases in sponsorship and paid registration. This event is held each year in the second quarter, and all revenues and cost associated with this event are recognized in the quarter in which the event is held. We believe excluding Knowledge revenues facilitates a more meaningful comparison between comparative periods for our professional services and other revenues and gross profit. Excluding Knowledge revenues, we expect professional services and other revenues to increase at a slower rate compared to subscription revenues as we are increasingly focused on deploying our internal professional services organization as a strategic resource and relying on our partner ecosystem to contract directly with customers for service delivery.

Our international operations have provided and will continue to provide a significant portion of our total revenues, and we have, in the past, experienced material fluctuations in our non-U.S. revenues and billings as a result of significant movements in certain major foreign exchange rates. However, during the three months ended June 30, 2016, foreign exchange rate fluctuations did not significantly impact our actual year-over-year revenue growth.

Cost of Revenues and Gross Profit Percentage

	Three Months Ended June 30, 2016	2015	% Change
	(dollars in thousands)		
Cost of revenues:			
Subscription	$56,360	$45,392	24 %
Professional services and other	40,289	34,325	17 %
Total cost of revenues	$96,649	$79,717	21 %
Gross profit percentage:			
Subscription	81 %	77 %	
Professional services and other	20 %	26 %	
Total gross profit percentage	71 %	68 %	
Gross Profit	$244,663	$166,999	
Headcount (at period end)			
Subscription	646	513	26 %
Professional services and other	493	443	11 %
Total headcount	1,139	956	19 %

Cost of subscription revenues increased $11.0 million during the three months ended June 30, 2016, compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of $4.0 million in personnel related costs excluding stock-based compensation and an increase of $0.9 million in stock-based compensation. In addition, there was an increase of $2.0 million in overhead expenses, an increase of $1.3 million in data center capacity costs due to the expansion of our data centers, and an increase of $1.9 million in depreciation expense primarily due to purchases of cloud-based infrastructure hardware equipment for our data centers.

Our subscription gross profit percentage increased to 81% for the three months ended June 30, 2016, from 77% for the three months ended June 30, 2015, due to data center density and improved economies of scale. We expect our cost of subscription revenues to increase in absolute dollar terms as we provide subscription services to more customers and increase the number of users within our customer instances. We expect our subscription gross profit percentage for the remainder of the year to remain relatively flat. To the extent future acquisitions are consummated, our cost of subscription revenues may increase due to additional non-cash charges associated with the amortization of intangible assets acquired. Our forecast for revenues, cost of revenues, and operating expenses was based on foreign exchange rates as of June 30, 2016.

Cost of professional services and other revenues increased $6.0 million during the three months ended June 30, 2016 as compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of $2.7 million in personnel related costs excluding stock-based compensation, an increase of $1.3 million in contracted third-party partner costs, an increase of $0.4 million in stock-based compensation, and an increase of $1.1 million in overhead expenses.

Our professional services and other gross profit percentage decreased to 20% for the three months ended June 30, 2016, from 26% for the three months ended June 30, 2015, due to lower utilization rates, partially offset by the increase in revenues from our annual Knowledge user conference. Costs associated with Knowledge are included in sales and marketing expense. Knowledge contributed $12.8 million to revenues, or 27 percentage points to the professional services and other gross profit percentage for the three months ended June 30, 2016. For the three months ended June 30, 2015, Knowledge contributed $10.9 million to revenues, or 23 percentage points to the professional services and other gross profit percentage.

Foreign exchange rate fluctuations from the second quarter of 2015 to the second quarter of 2016 did not significantly impact our cost of revenues.

Sales and Marketing

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Sales and marketing	$186,506	$136,574	37 %
Percentage of revenues	55 %	55 %	
Headcount (at period end)	1,669	1,169	43 %

Sales and marketing expenses increased $49.9 million during the three months ended June 30, 2016 compared to the same period in the prior year, primarily due to increased headcount that resulted in an increase of $24.4 million in personnel related costs excluding stock-based compensation, an increase of $6.8 million in stock-based compensation, an increase of $6.6 million in overhead expenses and an increase of $3.2 million in commissions expense. Commissions and referral fees amounted to 7% and 8% of subscription revenues for three months ended June 30, 2016 and 2015, respectively. In addition, expenses related to our annual Knowledge user conference increased $3.0 million, from $21.0 million for the three months ended June 30, 2015 to $24.0 million for the three months ended June 30, 2016, due to the number of attendees increasing by 31% year-over-year. Marketing program expenses, which include events, advertising and market data, increased $4.3 million during the three months ended June 30, 2016 compared to the same period in the prior year. Foreign exchange rate fluctuations from the second quarter of 2015 to the second quarter of 2016 did not significantly impact our sales and marketing expenses.

Excluding the charges related to Knowledge, we expect sales and marketing expenses to increase for the remainder of the year in absolute dollar terms, as we continue to expand our direct sales force, increase our marketing activities, grow our international operations, build brand awareness and sponsor additional marketing events, but decrease as a percentage of total revenues as we gain efficiencies in our sales and marketing efforts.

Research and Development

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Research and development	$70,364	$53,276	32 %
Percentage of revenues	21 %	22 %	
Headcount (at period end)	897	681	32 %

Research and development expenses increased $17.1 million during the three months ended June 30, 2016 compared to the same period in the prior year, primarily due to increased headcount, which resulted in an increase of $9.6 million in personnel related costs excluding stock-based compensation, an increase of $3.1 million in stock-based compensation and an increase of $3.0 million in overhead expenses. Foreign exchange rate fluctuations from the second quarter of 2015 to the second quarter of 2016 did not significantly impact our research and development expenses.

We expect research and development expenses to increase for the remainder of the year in absolute dollar terms, but remain relatively flat as a percentage of total revenues as we continue to improve the existing functionality of our services, develop new applications to fill market needs and continue to enhance our platform.

28

General and Administrative

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
General and administrative	$36,071	$30,384	19 %
Percentage of revenues	11 %	12 %	
Headcount (at period end)	536	381	41 %

General and administrative expenses increased $5.7 million during the three months ended June 30, 2016, compared to the same period in the prior year, primarily due to increased headcount, which resulted in an increase of $2.9 million in personnel related costs excluding stock-based compensation, and an increase of $0.6 million in stock-based compensation. Foreign exchange rate fluctuations from the second quarter of 2015 to the second quarter of 2016 did not significantly impact our general and administrative expenses.

We expect general and administrative expenses to increase for the remainder of the year in absolute dollar terms due to increased headcount, but decrease slightly as a percentage of total revenues as we continue to grow.

Stock-based Compensation

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Cost of revenues:			
Subscription	$6,951	$6,067	15 %
Professional services and other	6,136	5,771	6 %
Sales and marketing	32,861	26,105	26 %
Research and development	21,047	17,935	17 %
General and administrative	11,070	10,468	6 %
Total stock-based compensation	$78,065	$66,346	18 %
Percentage of revenues	23 %	27 %	

Stock-based compensation increased $11.7 million during the three months ended June 30, 2016, compared to the same period in the prior year, primarily due to equity grants to new employees and additional grants to current employees.

Stock-based compensation is inherently difficult to forecast due to fluctuations in our stock price. We expect stock-based compensation to continue to remain relatively flat for the remainder of the year in absolute dollar terms and as a percentage of total revenues.

Interest Expense

Three Months Ended June 30,		% Change
2016	2015	
(dollars in thousands)		

Interest expense	$8,248	$7,707	7 %
Percentage of revenues	2 %	3 %	

Interest expense increased $0.5 million during the three months ended June 30, 2016 compared to the same period in the prior year, due to the increase in amortization expense of debt discount and issuance costs related to our convertible senior notes, or the Notes, issued in November 2013. For the remainder of the year, we expect to incur approximately $16.9 million in amortization expense of debt discount and issuance costs related to the Notes.

Interest Income and Other Income (Expense), net

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Interest income	$1,964	$1,074	83 %
Foreign currency exchange gain/(loss)	374	(534)	NM
Other	(78)	(19)	NM
Interest and other income (expense), net	$2,260	$521	NM
Percentage of revenues	1 %	— %	

Interest income and other income (expense), net, increased $1.7 million during the three months ended June 30, 2016 compared to the same period in the prior year, primarily due to foreign exchange gains and increased interest income. We had foreign exchange gains of $0.4 million for the three months ended June 30, 2016 compared to losses of $0.5 million for the three months ended June 30, 2015 as a result of fluctuations in foreign currency exchange rates. Interest income increased $0.9 million due to the higher investment balances for the three months ended June 30, 2016.

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

Provision for (Benefit from) Income Taxes

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Loss before income taxes	$(54,266)	$(60,421)	(10)%
Provision for (benefit from) income taxes	(4,641)	1,504	NM
Effective tax rate	9 %	(2)%	

Our effective tax rate changed to 9% for the three months ended June 30, 2016 compared to (2)% for the three months ended June 30, 2015 primarily due to our loss from operations, the foreign tax rate differential, a release of the valuation allowance in connection with acquisitions and excess tax benefits related to stock-based compensation.

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

30

Net Loss

	Three Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Net loss	$(49,625)	$(61,925)	(20)%
Percentage of revenues	(16)%	(25)%	

Net loss decreased $12.3 million during the three months ended June 30, 2016 compared to the same period in the prior year as our revenue growth exceeded our growth in expenses. We expect to continue to incur a GAAP loss for the remainder of the year due to increased costs and expenses including non-cash charges associated with equity awards, amortization of purchased intangibles from business combinations and other expenses.

Comparison of the Six Months Ended June 30, 2016 and 2015

Revenues

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Revenues:			
Subscription	$558,101	$380,368	47 %
Professional services and other	89,090	78,312	14 %
Total revenues	$647,191	$458,680	41 %
Percentage of revenues:			
Subscription	86 %	83 %	
Professional services and other	14 %	17 %	
Total	100 %	100 %	

Subscription revenues increased $177.7 million during the six months ended June 30, 2016, compared to the same period in the prior year, driven by our upsells and an increase in our customer count.

Subscription revenues consist of the following:

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Enterprise Service Management solutions	$510,529	$353,286	45 %
IT Operations Management solutions	47,572	27,082	76 %
Total subscription revenues	$558,101	$380,368	47 %

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

Professional services and other revenues increased $10.8 million during the six months ended June 30, 2016, compared to the same period in the prior year, due to an increase in the services provided to our growing customer base. In addition, revenues from our annual Knowledge user conference increased to $12.8 million for the six months ended June 30, 2016 from $10.9 million for the six months ended June 30, 2015 due to increased sponsorship and paid registration in the current year.

Our international operations have provided and will continue to provide a significant portion of our total revenues, and we have, in the past, experienced material fluctuations in our non-U.S. revenues and billings as a result of significant movements in certain major foreign exchange rates. However, during the six months ended June 30, 2016, foreign exchange rate fluctuations did not significantly impact our actual year-over-year revenue growth.

Cost of Revenues and Gross Profit Percentage

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Cost of revenues:			
Subscription	$109,141	$87,836	24 %
Professional services and other	81,768	68,780	19 %
Total cost of revenues	$190,909	$156,616	22 %
Gross profit percentage:			
Subscription	80 %	77 %	
Professional services and other	8 %	12 %	
Total gross profit percentage	70 %	66 %	
Gross Profit	$456,282	$302,064	
Headcount (at period end)			
Subscription	646	513	26 %
Professional services and other	493	443	11 %
Total headcount	1,139	956	19 %

Cost of subscription revenues increased $21.3 million during the six months ended June 30, 2016, compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of $7.3 million in personnel related costs excluding stock-based compensation and an increase of $2.3 million in stock-based compensation. In addition, there was an increase of $3.6 million in overhead expenses, an increase of $2.8 million in data center capacity costs due to the expansion of our data centers, and an increase of $3.4 million in depreciation expense primarily due to purchases of cloud-based infrastructure hardware equipment for our data centers.

Our subscription gross profit percentage increased to 80% for the six months ended June 30, 2016, from 77% for the six months ended June 30, 2015, due to data center density and improved economies of scale.

Cost of professional services and other revenues increased $13.0 million during the six months ended June 30, 2016 as compared to the same period in the prior year, primarily due to increased headcount resulting in an increase of $4.8 million in personnel related costs excluding stock-based compensation, an increase of $3.3 million in contracted third-party partner costs, an increase of $1.9 million in stock-based compensation, and an increase of $2.2 million in overhead expenses.

Our professional services and other gross profit percentage decreased to 8% for the six months ended June 30, 2016, from 12% for the six months ended June 30, 2015, due to lower utilization rates and higher growth rate in our stock-based compensation of 17% compared to the growth rate in our professional services and other revenues of 14%, partially offset by the increase in revenues from our annual Knowledge user conference. Cost associated with Knowledge are included in sales and marketing expenses. Knowledge contributed $12.8 million to revenues, or 15 percentage points, to the professional services and other gross profit percentage for the six months ended June 30, 2016. For the six months ended June 30, 2015, Knowledge contributed $10.9 million to revenues, and 14 percentage points to the professional services and other gross profit percentage.

Foreign exchange rate fluctuations from the first half of 2015 to the first half of 2016 did not significantly impact our cost of revenues.

Sales and Marketing

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Sales and marketing	$345,116	$246,631	40 %
Percentage of revenues	53 %	54 %	
Headcount (at period end)	1,669	1,169	43 %

Sales and marketing expenses increased $98.5 million during the six months ended June 30, 2016 compared to the same period in the prior year, primarily due to increased headcount that resulted in an increase of $49.5 million in personnel related costs excluding stock-based compensation, an increase of $15.2 million in stock-based compensation, an increase of $12.5 million in overhead expenses and an increase of $6.1 million in commissions expense. Commissions and referral fees amounted to 7% and 9% of subscription revenues for six months ended June 30, 2016 and 2015, respectively. In addition, expenses related to our annual Knowledge user conference increased $3.0 million, from $21.0 million for the six months ended June 30, 2015 to $24.0 million for the six months ended June 30, 2016, due to the number of attendees increasing by 31% year-over-year. All other marketing program expenses, which include events, advertising and market data, increased $9.8 million during the six months ended June 30, 2016 compared to the same period in the prior year. Foreign exchange rate fluctuations from the first half of 2015 to the first half of 2016 did not significantly impact our sales and marketing expenses.

Research and Development

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Research and development	$136,288	$103,124	32 %
Percentage of revenues	21 %	22 %	
Headcount (at period end)	897	681	32 %

Research and development expenses increased $33.2 million during the six months ended June 30, 2016 compared to the same period in the prior year, primarily due to increased headcount, which resulted in an increase of $17.5 million in personnel related costs excluding stock-based compensation, an increase of $8.0 million in stock-based compensation and an increase of $5.4 million in overhead expenses. Foreign exchange rate fluctuations from the first half of 2015 to the first half of 2016 did not significantly impact our research and development expenses.

General and Administrative

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
General and administrative	$77,308	$59,776	29 %
Percentage of revenues	12 %	13 %	
Headcount (at period end)	536	381	41 %

General and administrative expenses increased $17.5 million during the six months ended June 30, 2016, compared to the same period in the prior year, primarily due an increase of $4.8 million in outside services driven by an increase in attorney fees associated with our litigations and an increase in contractors to support our administrative functions. In addition, personnel related costs excluding stock-based compensation increased $6.2 million, and stock-based compensation increased $1.5 million, primarily driven by increased headcount. Foreign exchange rate fluctuations from the first half of 2015 to the first half of 2016 did not significantly impact our general and administrative expenses.

Legal Settlements

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Legal settlements	$270,000	$ —	NM
Percentage of revenues	42 %	—%	

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

Stock-based Compensation

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Cost of revenues:			
Subscription	$13,558	$11,232	21 %
Professional services and other	12,895	10,984	17 %
Sales and marketing	63,859	48,679	31 %
Research and development	41,580	33,573	24 %
General and administrative	21,481	19,952	8 %
Total stock-based compensation	$153,373	$124,420	23 %
Percentage of revenues	24 %	27 %	

Stock-based compensation increased $29.0 million during the six months ended June 30, 2016, compared to the same period in the prior year, primarily due to equity grants to new employees and additional grants to current employees.

Interest Expense

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Interest expense	$16,357	$15,285	7 %
Percentage of revenues	3 %	2 %	

Interest expense increased $1.1 million during the six months ended June 30, 2016 compared to the same period in the prior year, due to the increase in amortization expense of debt discount and issuance costs related to our Notes issued in November 2013.

Interest Income and Other Income (Expense), net

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Interest income	$3,789	$2,022	87 %
Foreign currency exchange gain/(loss)	(959)	3,292	(129)%
Other	132	(89)	NM
Interest and other income (expense), net	$2,962	$5,225	(43)%
Percentage of revenues	— %	— %	

Interest income and other income (expense), net, decreased $2.3 million during the six months ended June 30, 2016 compared to the same period in the prior year, primarily due to foreign exchange losses, partially offset by increased interest income. We had foreign exchange losses of $1.0 million for the six months ended June 30, 2016 compared to gains of $3.3 million for the six months ended June 30, 2015 as a result of fluctuations in foreign currency exchange rates. Interest income increased $1.8 million due to the higher investment balances for the six months ended June 30, 2016.

Provision for (Benefit from) Income Taxes

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Loss before income taxes	$(385,825)	$(117,527)	228 %
Provision for (benefit from) income taxes	(2,868)	2,491	NM
Effective tax rate	1 %	(2)%	

Our effective tax rate changed to 1% for the six months ended June 30, 2016 compared to (2)% for the six months ended June 30, 2015 primarily due to our loss from operations, the foreign tax rate differential, a release of the valuation allowance in connection with acquisitions and excess tax benefits related to stock-based compensation.

Net Loss

	Six Months Ended June 30,		% Change
	2016	2015	
	(dollars in thousands)		
Net loss	$(382,957)	$(120,018)	219 %
Percentage of revenues	(61)%	(26)%	

Net loss increased $262.9 million during the six months ended June 30, 2016 compared to the same period in the prior year due primarily to the expenses related to the settlement agreements with HPE and BMC.

Liquidity and Capital Resources

	Six Months Ended June 30,	
	2016	2015
	(dollars in thousands)	
Net cash (used in) provided by operating activities	$(69,484)	$147,551
Net cash used in investing activities	(31,647)	(99,328)
Net cash (used in) provided by financing activities	(21,758)	29,238
Net (decrease) increase in cash and cash equivalents, net of foreign currency effect on cash and cash equivalents	(123,192)	72,899

Our principal sources of liquidity are our cash and cash equivalents, investments, and cash generated from operations. As of June 30, 2016, we had $806.7 million in cash and cash equivalents and short-term investments, of which $126.4 million represented cash owned by foreign subsidiaries. In addition, we had $224.4 million in long-term investments that provide additional capital resources.

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

Operating Activities

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

Net cash used in operating activities was $69.5 million for the six months ended June 30, 2016 compared to $147.6 million of net cash provided by operating activities for the six months ended June 30, 2015. The decrease in operating cash flow was primarily due to $267.5 million cash paid for aggregate legal settlements during the six months ended June 30, 2016 (refer to Note 15 in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for further details). The remaining change was due to an increase in non-cash adjustments to reconcile net loss to net cash provided by operations and the favorable impact on operating cash flow from changes in operating assets and liabilities.

Investing Activities

Net cash used in investing activities for the six months ended June 30, 2016 was $31.6 million compared to $99.3 million for the six months ended June 30, 2015. The decrease in cash used in investing activities was mainly due to $117.5 million decrease in net purchases of investments, offset by $33.2 million increase in business combinations, net of cash acquired, $14.9 million increase in purchase of other intangibles, and $11.1 million increase in capital expenditures related to purchases of cloud-based infrastructure hardware equipment to support the expansion of our data centers as well as investments in leasehold improvements, furniture and equipment to support our headcount growth.

Financing Activities

Net cash used in financing activities for the six months ended June 30, 2016 was $21.8 million compared to $29.2 million of net cash provided by financing activities for the six months ended June 30, 2015. The change was primarily due to the $47.3 million increase in taxes paid related to net share settlement of equity awards and the $7.5 million decrease in proceeds from employee stock plans.

Contractual Obligations and Commitments

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

Off-Balance Sheet Arrangements

During all periods presented, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in those types of relationships.

Critical Accounting Policies and Significant Judgments and Estimates

Our management's discussion and analysis of financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, as well as the reported revenues and expenses during the reporting periods. These items are monitored and analyzed by us for changes in facts and circumstances, and material changes in these estimates could occur in the future. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Changes in estimates are reflected in reported results for the period in which they become known. Actual results may differ from these estimates under different assumptions or conditions and such differences could be material.

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

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

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

PART II

ITEM 1. LEGAL PROCEEDINGS

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

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

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

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business and Industry

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

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

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

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

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

Sales outside of North America represented approximately 31% of our total revenues for each of the three and six months ended June 30, 2016. Our business and future prospects depend on increasing our international sales as a percentage of our total revenues, and the failure to grow internationally will harm our business. Additionally, operating in international markets requires significant investment and management attention and will subject us to regulatory and economic risks that are different from those in the United States. We have made, and will continue to make, substantial investments in data centers and cloud computing infrastructure, sales, marketing, personnel and facilities as we enter and expand in new geographic markets, such as Brazil and various countries within Asia. When we make these investments it is typically unclear whether, and when, sales in the new market will justify our investments, and we may significantly underestimate the level of investment and time required to be successful, or whether we will be successful. For example, our rate of acquisition of new Global 2000 customers, a key factor effecting our growth, has generally been greater in North America, Australia and in areas within Europe than it has been in Africa, Asia, Eastern Europe, South America and other markets in which we are less established. Accordingly, if we continue to further penetrate the Global 2000 at a higher rate in our established markets than in our emerging markets, over time an increasing percentage of the overall Global 2000 enterprises that are not yet our customers are in markets in which we have generally had a lower rate of customer acquisition or in which we are not yet competing. Additionally, currency fluctuations in certain countries and regions may negatively impact actual prices that partners and customers are willing to pay in those countries and regions, or the effective prices we realize in our reporting currency. We have experienced, and may continue to experience, difficulties in some of our investments in geographic expansion, including in hiring qualified sales management personnel. If we are unsuccessful in making these investments, or if our required investments are greater than anticipated, our revenue growth rate, business and operating results will be adversely affected.

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

The sales prices for our products, subscriptions and services may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of products and subscriptions, anticipation of the introduction of new products or subscriptions, or promotional programs. Competition continues to increase in the mark