NEW RELIC, INC.
Form 10-Q
August 04, 2017

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

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-36766

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

Delaware	26-2017431
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

188 Spear Street, Suite 1200
San Francisco, California 94105
(Address of principal executive offices, including zip code)
(650) 777-7600
(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 ý 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 ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a small reporting company)	Smaller reporting company
Emerging growth company		

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

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

As of July 27, 2017, there were 54,516,050 shares of the registrant’s common stock, par value $0.001 per share, outstanding.

1

NEW RELIC, INC.
Form 10-Q Quarterly Report
TABLE OF CONTENTS

Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to "New Relic," "we," "Company," "us," and "our" refer to New Relic, Inc. and its wholly owned subsidiaries. "New Relic," the New Relic logo, and other trademarks or service marks of New Relic that may appear in this Quarterly Report on Form 10-Q are the property of the Company. This Quarterly Report on Form 10-Q contains additional trade names, trademarks, and service marks of other companies. The Company does not intend its use or display of other companies' trade names, trademarks, or service marks to imply a relationship with, or endorsement or sponsorship of the Company by, these other companies.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- our future financial performance, including our revenue, cost of revenue, gross profit, gross margin, operating expenses, ability to generate positive cash flow, and ability to achieve and maintain profitability;
- the sufficiency of our cash and cash equivalents to meet our working capital, capital expenditure, and liquidity needs;
- our ability to attract and retain customers to use our products, to optimize the pricing for our products, to expand our sales to our customers, and to convince our existing customers to renew subscriptions;
- the evolution of technologies affecting our products and markets;
- our ability to innovate and provide a superior user experience and our intentions and strategy with respect thereto;
- our ability to successfully penetrate enterprise markets;
- our ability to successfully expand in our existing markets and into new markets, including international markets;
- the attraction and retention of key personnel;
- our ability to effectively manage our growth and future expenses;
- our ability to maintain, protect, and enhance our intellectual property;
- worldwide economic conditions and their impact on spending; and
- our ability to comply with modified or new laws and regulations applying to our business, including privacy and data security regulations.

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

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

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

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
NEW RELIC, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)
(Unaudited)

	June 30, 2017	March 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$105,298	$88,305
Short-term investments	122,000	118,101
Accounts receivable, net of allowance for doubtful accounts of $1,024 and $1,117, respectively	39,170	62,032
Prepaid expenses and other current assets	12,349	8,169
Total current assets	278,817	276,607
Property and equipment, net	51,136	50,728
Restricted cash	8,024	8,115
Goodwill	11,828	11,828
Intangible assets, net	2,102	2,499
Other assets	2,870	2,492
Total assets	$354,777	$352,269
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$5,235	$6,522
Accrued compensation and benefits	16,148	15,935
Other current liabilities	7,085	7,607
Deferred revenue	124,841	125,269
Total current liabilities	153,309	155,333
Deferred rent, non-current	7,979	8,272
Deferred revenue, non-current	807	1,135
Other liabilities, non-current	699	685
Total liabilities	162,794	165,425
Commitments and contingencies (Note 5)		
Stockholders’ equity:		
Common stock, $0.001 par value; 100,000 shares authorized at June 30, 2017 and March 31, 2017; 54,576 shares and 53,539 shares issued at June 30, 2017 and March 31, 2017, respectively; and 54,316 shares and 53,279 shares outstanding at June 30, 2017 and March 31, 2017, respectively	55	53
Treasury stock - at cost (260 shares)	(263)	(263)
Additional paid-in capital	468,402	447,314
Accumulated other comprehensive loss	(113)	(96)
Accumulated deficit	(276,098)	(260,164)
Total stockholders’ equity	191,983	186,844
Total liabilities and stockholders’ equity	$354,777	$352,269

See notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,	
	2017	2016
Revenue	$80,098	$58,607
Cost of revenue	14,977	11,655
Gross profit	65,121	46,952
Operating expenses:		
Research and development	18,266	15,969
Sales and marketing	49,361	38,786
General and administrative	13,942	10,236
Total operating expenses	81,569	64,991
Loss from operations	(16,448)	(18,039)
Other income (expense):		
Interest income	457	221
Interest expense	(22)	(21)
Other income (expense), net	314	(111)
Loss before income taxes	(15,699)	(17,950)
Income tax provision	235	121
Net loss	$(15,934)	$(18,071)
Net loss per share, basic and diluted	$(0.30)	$(0.36)
Weighted-average shares used to compute net loss per share, basic and diluted	53,697	50,224

See notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,	
	2017	2016
Net loss	$(15,934)	$(18,071)
Other comprehensive income (loss):		
Unrealized gain (loss) on available-for-sale securities, net of tax	(17)	10
Comprehensive loss	$(15,951)	$(18,061)

See notes to condensed consolidated financial statements.

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

	Three Months Ended June 30, 2017	2016
Cash flows from operating activities:		
Net loss:	$(15,934)	$(18,071)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	5,732	4,222
Stock-based compensation expense	9,623	7,338
Other	180	293
Changes in operating assets and liabilities:		
Accounts receivable	22,862	3,695
Prepaid expenses and other assets	(4,643)	(3,567)
Accounts payable	656	996
Accrued compensation and benefits and other liabilities	177	(324)
Deferred revenue	(757)	7,505
Deferred rent	(215)	1,319
Net cash provided by operating activities	17,681	3,406
Cash flows from investing activities:		
Purchases of property and equipment	(7,414)	(1,527)
Decrease in restricted cash	91	—
Purchases of short-term investments	(28,959)	(24,875)
Proceeds from sale and maturity of short-term investments	24,954	35,774
Capitalized software development costs	(732)	(712)
Net cash provided by (used in) investing activities	(12,060)	8,660
Cash flows from financing activities:		
Proceeds from exercise of employee stock options	11,372	3,675
Net cash provided by financing activities	11,372	3,675
Net increase in cash and cash equivalents	16,993	15,741
Cash and cash equivalents, beginning of period	88,305	65,914
Cash and cash equivalents, end of period	$105,298	$81,655
Supplemental disclosure of cash flow information:		
Cash paid for interest and income taxes	$99	$16
Noncash investing and financing activities:		
Property and equipment purchased but not yet paid	$520	$2,663

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1.Description of Business and Summary of Significant Accounting Policies

Description of Business—New Relic, Inc. (the "Company" or "New Relic") was founded in 2007 and incorporated in Delaware on February 20, 2008. The Company is a software-as-a-service provider of digital intelligence products that allow users to monitor software and infrastructure performance and measure end-user activities across desktop and mobile devices with applications deployed in the cloud or in a data center. New Relic's digital intelligence products and platform capabilities enable software developers, IT operations, and business users to better understand their digital business.

Basis of Presentation—These unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("GAAP") and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2017, as filed with the SEC on May 18, 2017 (the "Annual Report"). There have been no changes to the Company's significant accounting policies described in the Annual Report that have had a material impact on its condensed consolidated financial statements and related notes.

In the opinion of management, the unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, comprehensive loss and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full fiscal year ending March 31, 2018. The condensed consolidated balance sheet as of March 31, 2017 included herein was derived from the audited financial statements as of that date.

Use of Estimates—The preparation of the Company's condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of income and expenses during the reporting period. These estimates are based on information available as of the date of the condensed consolidated financial statements; therefore, actual results could differ from management's estimates.

Concentration of Risk—One customer represented 11% and 12% of the Company's accounts receivable balance as of June 30, 2017 and March 31, 2017, respectively. There were no customers that individually exceeded 10% of the Company's revenue during the three months ended June 30, 2017 or 2016.

Short-term Investments—Short-term investments consist of commercial paper, certificates of deposit, U.S. treasury securities, U.S. agency securities, and corporate debt securities and are classified as available-for-sale securities. The Company has classified its investments as current based on the nature of the investments and their availability for use in current operations. Available-for-sale securities are carried at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income, while realized gains and losses are reported within the statement of operations. The Company reviews its debt securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. The Company considers factors such as the length of time and extent to which the market value has been less than the cost, the financial position and near-term prospects of the issuer, and the Company's intent to sell, or whether it is more likely than not the Company will be required to sell the investment before recovery of the investment's amortized-cost basis. If the Company determines that an other-than-temporary decline exists in one of these securities, the respective investment would be written down to fair value. For debt securities, the portion of the write-down related to credit loss would be recognized as other income, net in the condensed consolidated statement of operations. Any portion not related to credit loss would be included in accumulated other comprehensive income (loss). The Company did not identify any investments as other-than-temporarily impaired as of June 30, 2017 and March 31, 2017.

Business Combinations—The Company recognizes identifiable assets acquired and liabilities assumed at their acquisition date fair value. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions as a part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, its estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill to the extent that the Company identifies adjustments to the preliminary purchase price allocation. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company’s condensed consolidated statements of operations. There has been no such adjustment as of June 30, 2017.

Goodwill—Goodwill represents the excess of the purchase price of an acquired business over the fair value of the underlying net tangible and intangible assets. Goodwill is evaluated for impairment annually in the third quarter of the Company’s fiscal year, and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. Triggering events that may indicate impairment include, but are not limited to, a significant adverse change in customer demand or business climate that could affect the value of goodwill or a significant decrease in expected cash flows. Since inception through June 30, 2017, the Company did not have any goodwill impairment.

Intangible Assets—Intangible assets consist of identifiable intangible assets, primarily developed technology, resulting from the Company’s acquisitions. Acquired intangible assets are recorded at cost, net of accumulated amortization. Intangible assets are amortized on a straight-line basis over their estimated useful lives.

Recent Accounting Pronouncements—In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new guidance provides principles for recognizing revenue to which an entity expects to be entitled for the transfer of promised goods or services to customers. The new guidance will be effective for the Company in its fiscal year beginning April 1, 2018. The guidance may be applied retrospectively to each prior period presented (full retrospective method), or with the cumulative effect recognized as of the date of initial adoption (modified retrospective method). The Company currently intends to adopt Topic 606 using the modified retrospective approach in the first quarter of fiscal year 2019. As the Company continues to assess the new standard along with industry trends and internal progress, the Company may adjust its implementation plan accordingly.

The Company anticipates that the significant impacts of adopting the new revenue standard will include the deferral of incremental commission costs of obtaining contracts and additional disclosure requirements. Currently, the Company records commissions as sales and marketing expenses as incurred. Under the new standard, the Company will capitalize incremental commissions related to initial contracts over the expected period of benefit. The Company has not yet concluded the amortization period of these capitalized costs, which will affect the classification and magnitude of the deferred costs at each reporting period. The Company will continue to quantify the effects of adopting Topic 606 on its condensed consolidated financial statements, including the impact on its revenue as well as the changes discussed above.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessees to put most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The new standard will be effective for the Company in the fiscal year beginning April 1, 2019; early adoption is permitted. The amendments require a modified retrospective approach with optional practical expedients. The Company is currently evaluating the impact of this standard on its condensed consolidated financial statements.

In March 2016, the FASB Issued ASU No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The updated guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted this standard in the first quarter of fiscal year 2018. Upon adoption, the Company recognized all of the previously unrecognized excess tax benefits related to stock awards using the modified retrospective transition method. These excess tax benefits, recognized upon adoption, were recorded as a deferred tax asset, which was then fully offset by the U.S. federal and state deferred tax asset valuation allowance resulting in no impact to the accumulated deficit. Without the valuation allowance, the Company's deferred tax asset would have increased by $39.5 million. All future excess tax benefits resulting from the settlement of stock awards will be recorded to the income tax provision.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which amends guidance on reporting credit losses for assets held at amortized cost basis and available-for-sale debt securities. The updated guidance requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down. The measurement of credit losses for newly recognized financial assets and subsequent changes in the allowance for credit losses are recorded in the statement of income. The update to the standard is effective for the Company in the fiscal year beginning April 1, 2020; early adoption is permitted in the fiscal year beginning April 1, 2019. The Company is currently evaluating the effect the standard will have on its condensed consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, which amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. The new guidance will be effective for the Company in its fiscal year beginning April 1, 2018. The Company is currently evaluating the impact of this standard on its condensed consolidated financial statements.

2. Fair Value Measurements

The following tables present information about the Company's financial assets measured at fair value on a recurring basis as of June 30, 2017 and March 31, 2017 based on the three-tier fair value hierarchy (in thousands):

	Fair Value Measurements as of June 30, 2017			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Money market funds	$36,202	$—	$ —	$36,202
Commercial paper	—	3,995	—	3,995
U.S. treasury securities	549	—	—	549
Short-term investments:				
Certificates of deposit	—	29,113	—	29,113
Commercial paper	—	12,006	—	12,006
Corporate notes and bonds	—	16,321	—	16,321
U.S. treasury securities	20,834	—	—	20,834
U.S. government agencies	—	43,726	—	43,726
Restricted cash:				
Money market funds	8,024	—	—	8,024
Total	$65,609	$105,161	$ —	$170,770
Included in cash and cash equivalents				$40,746
Included in short-term investments				$122,000
Included in restricted cash				$8,024

	Fair Value Measurements as of March 31, 2017			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Money market funds	$36,180	$—	$ —	$36,180
Commercial paper	—	5,441	—	5,441
U.S. government agencies	—	2,600	—	2,600
Short-term investments:				
Certificates of deposit	—	28,210	—	28,210
Commercial paper	—	10,549	—	10,549
Corporate notes and bonds	—	17,378	—	17,378
U.S. treasury securities	11,276	—	—	11,276
U.S. government agencies	—	50,688	—	50,688
Restricted cash:				
Money market funds	8,115	—	—	8,115
Total	$55,571	$114,866	$ —	$170,437
Included in cash and cash equivalents				$44,221

Included in short-term investments	$118,101
Included in restricted cash	$8,115

There were no transfers between fair value measurement levels during the three months ended June 30, 2017 and 2016.

Gross unrealized gains or losses for cash equivalents and short-term investments as of June 30, 2017 and March 31, 2017 were not significant. As of June 30, 2017 and March 31, 2017, there were no securities that were in an unrealized loss position for more than 12 months.

The following table classifies the Company's available-for-sale short-term investments by contractual maturities as of June 30, 2017 and March 31, 2017 (in thousands):

	June 30, 2017	March 31, 2017
Due within one year	$90,653	$92,874
Due in one to two years	31,347	25,227
Total	$122,000	$118,101

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

3. Property and Equipment

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

	June 30, 2017	March 31, 2017
Computers, software, and equipment	$7,575	$7,060
Site operation equipment	30,072	25,874
Furniture and fixtures	1,773	1,770
Leasehold improvements	30,827	30,586
Capitalized software development costs	33,445	32,618
Total property and equipment	103,692	97,908
Less: accumulated depreciation and amortization	(52,556)	(47,180)
Total property and equipment, net	$51,136	$50,728

Depreciation and amortization expense related to property and equipment was $5.3 million and $4.0 million for the three months ended June 30, 2017 and 2016, respectively.

4. Goodwill and Purchased Intangibles Assets

There were no changes to the carrying amount of goodwill for the three months ended June 30, 2017.

Purchased intangible assets subject to amortization as of June 30, 2017 consist of the following (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$ 4,900	$ (2,798)	$ 2,102

Purchased intangible assets subject to amortization as of March 31, 2017 consist of the following (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$ 4,900	$ (2,401)	$ 2,499

Amortization expense of purchased intangible assets was $0.4 million and $0.2 million for the three months ended June 30, 2017 and 2016, respectively.
Estimated future amortization expense as of June 30, 2017 is as follows (in thousands):

Fiscal Years Ending March 31,	Estimated Future Amortization Expense
2018 (remaining 9 months)	790
2019	787
2020	525
	$ 2,102

5. Commitments and Contingencies
Leases—The Company leases office space under non-cancelable operating lease agreements, which expire from 2017 through 2027.
Deferred Rent—Certain of the Company’s operating leases contain rent holidays, allowances, and rent escalation provisions. For these leases, the Company recognizes the related rental expense on a straight-line basis over the life of the lease from the date the Company takes possession of the office and records the difference between amounts charged to operations and amounts paid as deferred rent. These rent holidays, allowances, and rent escalations are considered in determining the straight-line expense to be recorded over the lease term. As of June 30, 2017 and March 31, 2017, $9.0 million and $9.2 million was recorded as deferred rent, respectively.
Rent expense, net of sublease income, for operating leases was $2.6 million and $2.4 million for the three months ended June 30, 2017 and 2016, respectively.
Future minimum lease payments under non-cancelable operating leases as of June 30, 2017 were as follows (in thousands):

Fiscal Years Ending March 31,	Operating Leases
2018 (remaining 9 months)	$ 8,213
2019	11,333
2020	12,403
2021	9,268
2022	7,714
Thereafter	19,540
Total minimum future lease payments	$ 68,471

Purchase Commitments—As of June 30, 2017 and March 31, 2017, the Company had purchase commitments of $26.2 million and $29.9 million, respectively, primarily related to hosting services.
Legal Proceedings—From time to time, the Company may become involved in various legal proceedings in the ordinary course of its business, and may be subject to third-party infringement claims.
On November 5, 2012, CA, Inc. filed suit against the Company in the United States District Court, Eastern District of New York for alleged patent infringement. CA, Inc.’s complaint against the Company claims that certain aspects of the Company’s products infringe certain patents held by CA, Inc. Discovery is complete in the case, and the court has ruled on summary judgment motions filed by both parties. A trial date has not been set as of June 30, 2017. The Company cannot at this time predict the likely outcome of this proceeding or estimate the amount or range of loss or possible loss that may arise from it. The Company has not accrued any loss related to the outcome of this case as of June 30, 2017.

11

In the normal course of business, the Company may agree to indemnify third parties with whom it enters into contractual relationships, including customers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed, under certain conditions, to hold these third parties harmless against specified losses, such as those arising from a breach of representations or covenants, other third-party claims that the Company's products when used for their intended purposes infringe the intellectual property rights of such other third parties, or other claims made against certain parties. To date, the Company has not incurred any costs as a result of such obligations and has not accrued any liabilities related to such obligations in the condensed consolidated financial statements. In addition, the Company indemnifies its officers, directors, and certain key employees while they are serving in good faith in their respective capacities. The Company does not currently believe there is a reasonable possibility that a loss may have been incurred under these indemnification obligations. To date, there have been no claims under any such indemnification provisions.

6. Common Stock and Stockholders' Equity

Employee Stock Purchase Plan—The Company's board of directors adopted, and the Company's stockholders approved, the Company's 2014 Employee Stock Purchase Plan (the "ESPP"), which became effective in December 2014. The ESPP initially reserved and authorized the issuance of up to 1,000,000 shares of common stock. The ESPP provides that the number of shares reserved and available for issuance under the ESPP automatically increases each April, beginning on April 1, 2015, by the lesser of 500,000 shares, 1% of the number of the Company's common stock shares issued and outstanding on the immediately preceding March 31, or such lesser number of shares as determined by the Company's board of directors. For each of the three months ended June 30, 2017 and 2016, no shares of common stock were purchased under the ESPP. Stock-based compensation expense recognized related to the ESPP was $0.4 million and $0.5 million for the three months ended June 30, 2017 and 2016, respectively. As of June 30, 2017, there were 2,147,744 shares available for issuance under the ESPP.

2008 Equity Incentive Plan—The Company's board of directors adopted, and the Company's stockholders approved, the 2008 Equity Incentive Plan (the "2008 Plan") in February 2008. The 2008 Plan was terminated in connection with the Company's initial public offering ("IPO"), and accordingly, no shares are available for future issuance under this plan. The 2008 Plan continues to govern outstanding awards granted thereunder.

2014 Equity Incentive Plan—The Company's board of directors adopted, and the Company's stockholders approved, the Company's 2014 Equity Incentive Plan (the "2014 Plan"), which became effective in December 2014. The 2014 Plan serves as the successor to the Company's 2008 Plan. The 2014 Plan initially reserved and authorized the issuance of 5,000,000 shares of the Company's common stock. Additionally, shares not issued or subject to outstanding grants under the 2008 Plan upon its termination became available under the 2014 Plan, resulting in a total of 5,184,878 available shares under the 2014 Plan as of the effective date of the 2014 Plan. Pursuant to the terms of the 2014 Plan, any shares subject to outstanding stock options or other stock awards under the 2008 Plan that (i) expire or terminate for any reason prior to exercise or settlement, (ii) are forfeited because of the failure to meet a contingency or condition required to vest such shares or otherwise return to the Company or (iii) are reacquired, withheld (or not issued) to satisfy a tax withholding obligation in connection with an award or to satisfy the purchase price or exercise price of a stock award will become available for issuance pursuant to awards granted under the 2014 Plan. The 2014 Plan provides that the number of shares reserved and available for issuance under the plan automatically increases each April 1, beginning on April 1, 2015, by 5% of the outstanding number of shares of the Company's common stock shares issued and outstanding on the immediately preceding March 31, or such lesser number of shares as determined by the Company's board of directors. As of June 30, 2017, there were 9,961,033 shares available for issuance under the 2014 Plan.

The following table summarizes the Company’s stock option and RSU award activities for the three months ended June 30, 2017 (in thousands, except per share information):

	Options Outstanding				RSUs Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value	Number of Shares	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding - April 1, 2017	4,607	$ 17.49	7.1	$ 90,339	1,978	$ 29.32	2.8	$ 73,309
Stock options granted	415	44.49						
RSUs granted					737	44.00		
Stock options exercised	(856)	13.27		24,841				
RSUs vested					(181)	27.97		
Stock options canceled/forfeited	(204)	25.98						
RSUs canceled/forfeited					(211)	30.13		
Outstanding - June 30, 2017	3,962	$ 20.79	6.9	$ 88,651	2,323	$ 34.01	3.0	$ 99,898

Stock-Based Compensation Expense—Stock-based compensation expense for both employees and nonemployees was $9.6 million and $7.3 million for the three months ended June 30, 2017 and 2016, respectively. Cost of revenue, research and development, sales and marketing, and general and administrative expenses were as follows (in thousands):

	Three Months Ended June 30,	
	2017	2016
Cost of revenue	$526	$381
Research and development	2,836	2,541
Sales and marketing	4,306	2,762
General and administrative	1,955	1,654
Total stock-based compensation expense	$9,623	$7,338

As of June 30, 2017, unrecognized stock-based compensation cost related to outstanding unvested stock options was $21.3 million, which is expected to be recognized over a weighted-average period of approximately 2.2 years. As of June 30, 2017, unrecognized stock-based compensation cost related to outstanding unvested stock units was $73.6 million, which is expected to be recognized over a weighted-average period of approximately 2.9 years.

7. Income Taxes

The Company is subject to income tax in the United States as well as other tax jurisdictions in which it conducts business. Earnings from non-U.S. activities are subject to local country income tax. The Company does not provide for federal income taxes on the undistributed earnings of its foreign subsidiaries as such earnings are expected to be reinvested indefinitely.

The Company recorded an income tax provision of $0.2 million and $0.1 million for the three months ended June 30, 2017 and 2016, respectively, related to foreign income taxes and state minimum taxes. Based on the available objective evidence during the three months ended June 30, 2017, the Company believes it is more likely than not that the tax benefits of the U.S. losses incurred during the three months ended June 30, 2017 may not be realized. Accordingly, the Company did not record the tax benefits of U.S. losses incurred during the three months ended June 30, 2017. The primary difference between the effective tax rate and the local statutory tax rate relates to the valuation allowance on the Company’s U.S. losses, foreign tax rate differences, and amortization of a deferred charge associated with the intercompany transfer of intellectual property from prior periods.

8. Net Loss Per Share

Basic loss per share is calculated by dividing net loss by the weighted-average number of common shares outstanding during the period, less shares subject to repurchase, and excludes any dilutive effects of employee share-based awards and warrants. Diluted net loss per common share is computed giving effect to all potential dilutive common shares, including common stock issuable upon exercise of stock options and unvested restricted common stock. As the Company had net losses for each of the three months ended June 30, 2017 and 2016, all potential common shares were determined to be anti-dilutive, resulting in basic and diluted net loss per share being equal.

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

	Three Months Ended June 30,	
	2017	2016
Numerator:		
Net loss	$(15,934)	$(18,071)
Denominator:		
Weighted average shares used to compute net loss per share, basic and diluted	53,697	50,224
Net loss per share—basic and diluted	$(0.30)	$(0.36)

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

	As of June 30,	
	2017	2016
Options to purchase common stock	3,962	6,544
Restricted stock units	2,323	2,205
ESPP shares	86	104
Common stock reserved for issuance in connection with acquisition	43	90
	6,414	8,943

9. Revenue by Geographic Location

The following table shows the Company’s revenue by geographic areas, as determined based on the billing address of its customers (in thousands):

	Three Months Ended June 30,	
	2017	2016
United States	$54,779	$39,810
EMEA	14,868	10,929
APAC	5,894	4,540
Other	4,557	3,328
Total revenue	$80,098	$58,607

Substantially all of the Company’s long-lived assets were attributable to operations in the United States as of June 30, 2017 and March 31, 2017.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties. When reviewing the discussion below, you should keep in mind the substantial risks and uncertainties that could impact our business. In particular, we encourage you to review the risks and uncertainties described in Part II, Item 1A “Risk Factors” included elsewhere in this report. These risks and uncertainties could cause actual results to differ materially from those projected in forward-looking statements contained in this report or implied by past results and trends. Forward-looking statements are statements that attempt to forecast or anticipate future developments in our business, financial condition or results of operations. See the section titled “Special Note Regarding Forward-Looking Statements” in this report. These statements, like all statements in this report, speak only as of their date (unless another date is indicated), and we undertake no obligation to update or revise these statements in light of future developments, except as required by law.

Overview

We help companies see their digital business more clearly. Our cloud-based platform and suite of products, which we call the New Relic Digital Intelligence Platform, enables organizations to collect, store, and analyze massive amounts of data in real time so they can better understand their application and infrastructure performance, improve their digital customer experience, and achieve business success. We design all our products to be highly intuitive and frictionless; they are easy to deploy, and customers can rapidly, often within minutes, realize benefits and results. Software developers can build better applications faster, as they can see how their software will perform and is actually performing for end-users. IT operations teams can use our products to quickly find and fix performance problems as well as prevent future issues. Business users such as product managers can get answers to how their new product launch is being received, or how a pricing change impacted customer retention, without waiting for help from IT. For each of these audiences—software developers, IT operations, and business users—we aim to be the first, best place to look to understand their digital business.

We were founded in 2007 and we launched our first product offering, New Relic APM (Application Performance Management), in 2008. Since then, we have broadened our product offerings to support a wide variety of programming languages and frameworks and have added a number of additional products and platform capabilities that now form the New Relic Digital Intelligence Platform. For example, in 2013, we released New Relic Mobile to support mobile by providing native mobile application performance management for the iOS and Android mobile operating systems; in 2014, we released New Relic Browser to improve browser-side performance, New Relic Synthetics to enable our users to test their software through simulated usage and New Relic Insights to leverage big data analytics; and in 2016, we released New Relic Infrastructure to provide real-time visibility into critical configuration changes that affect a company’s cloud infrastructure.

We sell our products primarily through direct sales and marketing channels utilizing a wide range of online and offline sales and marketing activities. The majority of our users visit our website, create an account, and deploy our software. Many users initially subscribe to one of our products to address a particular use case and broaden the usage of our products as they become more familiar with our products. For larger mid-market and enterprise organizations, our sales team focuses on leveraging users in existing accounts to expand our product users and usage across the organization. Although enterprise organizations constitute a minority of our total paid business accounts, the revenue we receive from enterprise companies is on pace to provide a majority of our overall revenue by the end of the fiscal year ended March 31, 2018.

We offer access to the New Relic Digital Intelligence Platform under subscription plans that also include service and support. Our plans typically have terms of one year, although some of our customers commit for shorter or longer periods. We recognize revenue from subscription fees ratably over the service period. Historically, most of our customers have paid us on a monthly basis. As a result, our deferred revenue at any given period of time has been relatively low. In recent periods we have secured an increased percentage of multi-year commitments, which has grown as we have sold more to larger organizations. Because we generally invoice many of these larger organizations less frequently, our deferred revenue has increased over time, and we expect it to continue to increase on a year-over-year basis. However, due to our mix of subscription plans and billing frequencies, we do not believe that changes in our deferred revenue in a given period are directly correlated with our revenue growth.

We have grown rapidly in recent periods, with revenue for the three months ended June 30, 2017 and 2016 of $80.1 million and $58.6 million, respectively, representing year-over-year growth of 37%. We expect that the rate of growth in our revenue will decline over the long term as our business scales, even if our revenue continues to grow in absolute terms. We have continued to make significant expenditures and investments, including in personnel-related costs, sales and marketing, infrastructure and operations, and have incurred net losses in each period since our inception, including net losses of $15.9

million and $18.1 million for the three months ended June 30, 2017 and 2016, respectively. Our accumulated deficit as of June 30, 2017 was $276.1 million.

Internationally, we currently offer our products in Europe, Middle East, and Africa, or EMEA; Asia-Pacific, or APAC; and other non-U.S. locations, as determined based on the billing address of our customers, and our revenue from those regions constituted 19%, 7%, and 6%, respectively, of our revenue for the three months ended June 30, 2017, and 19%, 8%, and 6%, respectively, of our revenue for the three months ended June 30, 2016. We believe there is further opportunity to increase our international revenue overall and as a proportion of our revenue, and we are increasingly investing in our international operations and intend to invest in further expanding our footprint in international markets.

Our employee headcount has increased to 1,164 employees as of June 30, 2017 from 959 employees as of June 30, 2016 and we plan to continue to invest aggressively in the growth of our business to take advantage of our market opportunity. For example, we intend to continue to increase our investment in sales and marketing, as we further expand our sales teams, increase our marketing activities, and grow our international operations, particularly as we increase our sales to larger organizations. In addition, we plan to continue to invest in our research and development organization to enhance and further develop our products and platform capabilities.

While these areas represent significant opportunities for us, we also face significant risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results. We are continuing to incur expenses in the near term as we continue to invest in the growth of our sales and expansion of paid business accounts. However, we may not realize any long-term benefit from these investments in the growth of our business. In addition, any investments that we make in sales and marketing or other areas will occur in advance of our experiencing any benefits from such investments, so it may be difficult for us to determine if we are efficiently allocating our resources in these areas. As a result, we have never achieved profitability and we do not expect to be profitable for the foreseeable future. Further, our reported revenue, operating results, and cash flows for a given period may not be indicative of future results due to our limited operating history and fluctuations in the number of new employees, the rate of our expansion, the timing of expenses we incur to grow our business and operations, levels of competition, and market demand for our products.

Factors Affecting Our Performance

Market Adoption of Our Products. We are defining a new category of software, which we refer to as digital intelligence. Our success is dependent on the market adoption of this emerging category of software, which may not yet be well understood by the market. For the foreseeable future, we expect that our revenue growth will be primarily driven by the pace of adoption and penetration of our products and we will incur significant expenses associated with educating the market about the benefits of our products.

Increasing the Number of Paid Business Accounts. Our future growth is dependent on our ability to increase the number of accounts that pay us to use our products. Many users experience our products with a free trial after which they have the option to purchase one or more of our subscription plans. We believe that we have a significant competitive advantage as our users experience the ease of installation and the full set of features that our products deliver during the free trial period.

Retention and Expansion within Paid Business Accounts. A key factor in our success is the retention and expansion of our subscription agreements with our existing customers. In order for us to continue to grow our business, it is important to generate additional revenue from our existing customers, and we intend to do this in several ways. As we improve our existing products and platform capabilities and introduce new products, we believe that the demand for our products will generally grow. We also believe that there is a significant opportunity for us to increase the number of subscriptions we sell to our current customers as they become more familiar with our products and adopt our products to address additional business use cases.

Investment in Sales and Marketing. We expect to continue to invest aggressively in sales and marketing to drive additional revenue. Any investments that we make in sales and marketing will occur in advance of our experiencing any benefits from such investments, so it may be difficult for us to determine if we are efficiently allocating our resources. As we continue to focus sales and marketing investments more heavily towards large organizations, this may require more of our resources. In addition, we expect our sales cycle to be longer and less predictable with respect to larger customers, which may delay realization of future sales. We also intend to increase our sales and marketing investment in international markets, such as Europe, and those markets may take longer and be more costly to develop than the U.S. market.

Key Operating Metrics

We review the following key metrics to evaluate our business, measure our performance, identify trends affecting our business, formulate business plans, and make key strategic decisions:

Number of Paid Business Accounts and Number of Paid Business Accounts with Annual Recurring Revenue over $100,000. We believe that our ability to increase our number of paid business accounts is one indicator of our market penetration, the growth of our business and our potential future prospects. We define the number of paid business accounts at the end of any particular period as the number of accounts at the end of the period, as identified by a unique account identifier, for which we have recognized revenue on the last day of the period indicated. A single organization or customer may have multiple paid business accounts for separate divisions, segments, or subsidiaries. We round the number of total paid business accounts that we report as of a particular date down to the nearest hundred. We had over 15,400 paid business accounts as of June 30, 2017. We expect the rate at which we add paid business accounts to decrease over time as we scale our business, but it may fluctuate from period to period as a result of the introduction of alternative pricing options for our products or other factors.

As a subset of this metric, we believe that our number of paid business accounts with annual recurring revenue over $100,000 is one indicator of our business as it relates to the acquisition of larger accounts within our overall customer base, including our market penetration of larger mid-market and enterprise customers, as well as deeper penetration into our existing customer base. For this purpose, we define annual recurring revenue as the revenue we would contractually expect to receive from those customers over the following 12 months, without any increase or reduction in any of their subscriptions. We had 555 paid business accounts with annual recurring revenue over $100,000 as of June 30, 2017, which was a 39.4% increase compared to 398 as of June 30, 2016. We believe this increase reflects our continued focus of a greater proportion of our sales and marketing efforts on larger mid-market and enterprise customers. As with our total paid business accounts, we expect the rate at which we add paid business accounts with annual recurring revenue over $100,000 to decrease over time as a result of deeper penetration into the enterprise market.

Percentage of Annualized Recurring Revenue from Enterprise Paid Business Accounts. We believe that our ability to increase the percentage of annualized recurring revenue from enterprise paid business accounts relative to our overall business is an important indicator of our success with respect to our focus in recent periods to improve our market penetration with enterprise companies. We define an enterprise paid business account as a paid business account that we measure to have over 1,000 employees. Growth or reduction reflected in this figure would include, in addition to the acquisition, loss or consolidation of enterprise paid business accounts, any changes we make to the categorization of existing paid business accounts, for example to reflect that they have expanded beyond the employee threshold, which we review periodically.

Our percentage of annualized recurring revenue from enterprise paid business accounts was 49% as of June 30, 2017, compared to 43% as of June 30, 2016. We expect the percentage of annualized recurring revenue from enterprise paid business accounts to increase over time. However, because of the size of our large installed base and potential seasonality in regard to selling into enterprise customers, we believe the percentage may not move significantly from quarter to quarter and we expect the rate of increase in the percentage of enterprise customers to moderate over time.

Annualized Revenue per Average Paid Business Account. We believe that our annualized revenue per average paid business account is another indicator of our business as it relates to the acquisition of larger accounts within our overall customer base, including our market penetration of larger mid-market and enterprise customers, as well as deeper penetration into our existing customer base. We define our annualized revenue per average paid business account as the annualized revenue for the current period divided by the average of the number of paid business accounts at the end of the current period and the end of the prior period. We round down our annualized revenue per average paid business account to the nearest $500.

Our annualized revenue per average paid business account for the quarter ended June 30, 2017 grew to over $20,500, which was an increase of 20.6% compared to approximately $17,000 for the quarter ended June 30, 2016. We believe this increase reflects our continued focus on larger mid-market and enterprise customers. We have experienced a decrease in the rate of growth of our annualized revenue per average paid business account and we expect the decrease to continue over time as our business scales and we introduce alternative pricing options for our products.

Dollar-Based Net Expansion Rate. Our ability to generate revenue is dependent on our ability to maintain and grow our relationships with our existing customers. We track our performance in this area by measuring our dollar-based net expansion rate. Our dollar-based net expansion rate increases when customers increase their use of our products, use additional products, or upgrade to a higher subscription tier. Our dollar-based net expansion rate is reduced when customers decrease their use of our products, use fewer products, or downgrade to a lower subscription tier.

Our dollar-based net expansion rate compares our recurring subscription revenue from customers from one period to the next. We measure our dollar-based net expansion rate on a monthly basis because many of our customers change their subscriptions more frequently than quarterly or annually. To calculate our annual dollar-based net expansion rate, we first establish the base period monthly recurring revenue from all our customers at the end of a month. This represents the revenue we would contractually expect to receive from those customers over the following month, without any increase or reduction in any of their subscriptions. We then (i) calculate the actual monthly recurring revenue from those same customers at the end of that following month; then (ii) divide that following month's recurring revenue by the base month's recurring revenue to arrive at our monthly net expansion rate; then (iii) calculate a quarterly net expansion rate by compounding the net expansion rates of the three months in the quarter; and then (iv) calculate our annualized net expansion rate by compounding our quarterly net expansion rate over an annual period.

The quarterly fluctuations in our dollar-based net expansion rate are primarily driven by transactions within a particular quarter in which certain paid business accounts from larger subscription customers either significantly upgrade or significantly downgrade their subscriptions and by increased sales to existing customers in particular quarters due to sales and marketing campaigns in a particular quarter. In addition, we believe that the composition of our customer base also has an impact on the net expansion rate, such that a relative increase in the number of paid business accounts from larger enterprises versus small to medium-sized organizations will tend to increase our quarterly net expansion rate, while a relative increase in the number or paid business accounts from small to medium-sized organizations versus larger enterprises will tend to decrease the quarterly net expansion rate, as smaller businesses tend to cancel subscriptions more frequently than larger enterprises. This rate is also impacted by factors including, but not limited to, new product introductions, promotional activity, mix of customer size, and the variable timing of renewals.

Our annualized dollar-based net expansion rate declined to 112.5% for the three-month period ended June 30, 2017 from 118.2% for the three-month period ended June 30, 2016. In the three-month period ended June 30, 2017, we saw a lower amount of upsell activity relative to our total installed base than the comparable period in the prior year. Although we drove larger upsell activity in absolute dollars during the fiscal quarter, the total installed base was larger than during the comparable period in the prior year due to an increase in number of customers, which had a moderating effect on our annualized dollar-based net expansion rate.

Key Components of Results of Operations

Revenue

We offer access to our products under subscription plans that include service and support for one or more of our products. For our paying customers, we offer a variety of pricing plans based on the particular product purchased by an account, number of servers monitored, number of applications monitored, or number of mobile devices monitored. Our plans typically have terms of one year, although some of our customers commit for shorter or longer periods. Historically, most of our customers have paid us on a monthly basis. As a result, our deferred revenue at any given period of time has been relatively low. As we have increased our sales to larger organizations, we have increasingly been invoicing our customers on a less frequent basis, and therefore, we expect our deferred revenue to continue to increase on a year-over-year basis.

Additionally, we expect our business to continue to become more seasonal as mid-market and enterprise customers start to represent a larger percentage of our revenues. The first two quarters of each fiscal year usually have lower sequential deferred revenue growth than the third and fourth fiscal quarters, during which we generally benefit from a larger renewal pool and opportunity to upsell existing customers. As a result, over time we could potentially see stronger sequential revenue results in our fourth and first fiscal quarters as our deferred revenue is recognized. We expect that this seasonality will continue to affect our sales and operating results in the future, which can make it difficult to achieve sequential growth in certain financial metrics or could result in sequential declines on a quarterly basis.

Cost of Revenue

Cost of revenue consists of expenses relating to data center operations, hosting-related costs, payment processing fees, depreciation and amortization, consulting costs, and salaries and benefits of operations and global customer support personnel. Salaries and benefits costs associated with our operations and global customer support personnel consist of salaries, benefits, bonuses, and stock-based compensation. We plan to continue increasing the capacity, capability, and reliability of our infrastructure to support the growth of our customer adoption and the number of products we offer and therefore expect a corresponding increase in our cost of revenue.

Gross Profit and Margin

Gross profit is revenue less cost of revenue. Gross margin is gross profit expressed as a percentage of revenue. Our gross margin has been, and will continue to be, affected by a number of factors, including the timing and extent of our investments in our operations and global customer support personnel, hosting-related costs, and the amortization of capitalized software. We expect that our gross margin will decline modestly over the long term, although we expect our gross margin to fluctuate from period to period as a result of these factors.

Operating Expenses

Personnel costs, which consist of salaries, benefits, bonuses, stock-based compensation and, with regard to sales and marketing expenses, sales commissions, are the most significant component of our operating expenses. We also incur other non-personnel costs such as an allocation of our general overhead expenses.

Research and Development. Research and development expenses consist primarily of personnel costs and an allocation of our general overhead expenses. We continue to focus our research and development efforts on adding new features and products, and increasing the functionality and enhancing the ease of use of our existing products. We capitalize the portion of our software development costs that meets the criteria for capitalization.

We plan to continue to hire employees for our engineering, product management, and design teams to support our research and development efforts. As a result, we expect our research and development expenses to continue to increase in absolute dollars for the foreseeable future. However, we expect our research and development expenses to decrease modestly as a percentage of our revenue over the long term, although our research and development expenses may fluctuate from period to period depending on fluctuations in our revenue and the timing and extent of our research and development expenses.

Sales and Marketing. Sales and marketing expenses consist of personnel costs for our sales, marketing, and business development employees and executives. Commissions are expensed in the period when a customer contract is executed. Sales and marketing expenses also include the costs of our marketing and brand awareness programs.

We plan to continue investing in sales and marketing globally by increasing the number of our sales personnel, expanding our domestic and international marketing activities, building brand awareness, and sponsoring additional marketing events. We expect our sales and marketing expenses to continue to increase in absolute dollars and continue to be our largest operating expense category for the foreseeable future. However, we expect our sales and marketing expenses to decrease as a percentage of our revenue over the long term, although our sales and marketing expenses may fluctuate from period to period depending on fluctuations in our revenue and the timing and extent of our sales and marketing expenses.

General and Administrative. General and administrative expenses consist primarily of personnel costs for our administrative, legal, human resources, information technology, finance and accounting employees, and executives. Also included are non-personnel costs, such as external legal and other professional fees.

We plan to continue to expand our business both domestically and internationally, and we expect to increase the size of our general and administrative function to support the growth of our business. We also expect that we will continue to incur additional general and administrative expenses as a result of being a publicly traded company. As a result, we expect our general and administrative expenses to continue to increase in absolute dollars for the foreseeable future. However, we expect our general and administrative expenses to decrease modestly as a percentage of our revenue over the long term, although our general and administrative expense may fluctuate from period to period depending on fluctuations in our revenue and the timing and extent of our general and administrative expenses, such as litigation costs.

Other Income, Net

Other income, net consists primarily of interest income, interest expense, and foreign exchange gains and losses.

Results of Operations

The following tables summarize our consolidated statements of operations data for the periods presented and as a percentage of our revenue for those periods.

	Three Months Ended June 30,	
	2017	2016
	(in thousands, except per share data)	
Revenue	$ 80,098	$ 58,607
Cost of revenue (1)	14,977	11,655
Gross profit	65,121	46,952
Operating expenses:		
Research and development (1)	18,266	15,969
Sales and marketing (1)	49,361	38,786
General and administrative (1)	13,942	10,236
Total operating expenses	81,569	