Zendesk, Inc.
Form 10-Q
May 07, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-36456

ZENDESK, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	26-4411091
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1019 Market Street

San Francisco, California 94103

(Address of principal executive offices)

415.418.7506

(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.

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

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

As of April 30, 2015, there were 86,093,863 shares of the registrant's common stock outstanding.

ZENDESK, INC.

TABLE OF CONTENTS

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,” “might,” “expects,” “plans,” “anticipates,” “could,” “i “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential,” or “continue” or the negative of these wor other similar terms or expressions that concern our expectations, strategy, plans, or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

our future financial performance, including our revenue, cost of revenue, gross profit, operating expenses, ability to generate positive cash flow, ability to improve our gross margin, and ability to achieve and maintain profitability;
the sufficiency of our cash and cash equivalents, and marketable securities to meet our liquidity needs;
our ability to attract and retain customers to use our customer service platform and live chat software, and to optimize the pricing for our customer service platform and live chat software;
the evolution of technology affecting our platform, services, and markets;
our ability to innovate and provide a superior customer experience;
our ability to successfully expand in our existing markets and into new markets;
the attraction and retention of qualified employees and key personnel;
our ability to effectively manage our growth and future expenses;
our ability to successfully offer our live chat software as a standalone service or further integrate it with our customer service platform;
our ability to maintain, protect, and enhance our intellectual property;
our ability to comply with modified or new laws and regulations applying to our business, including privacy and data security regulations;
worldwide economic conditions and their impact on information technology spending;
our ability to securely maintain customer data; and
our ability to maintain and enhance our brand.

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

ZENDESK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and shares)

	March 31, 2015 (Unaudited)	December 31, 2014
Assets		
Current Assets:		
Cash and cash equivalents	$ 264,222	$ 80,265
Marketable securities	44,855	42,204
Accounts receivable, net of allowance for doubtful accounts of $475 and $264 as of March 31, 2015 and December 31, 2014, respectively	12,001	11,523
Prepaid expenses and other current assets	6,047	5,013
Total current assets	327,125	139,005
Marketable securities, noncurrent	7,501	9,205
Property and equipment, net	43,351	41,895
Goodwill and intangible assets, net	13,255	14,152
Other assets	1,911	1,531
Total assets	$ 393,143	$ 205,788
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 3,778	$ 4,763
Accrued liabilities	8,893	7,841
Accrued compensation and related benefits	11,370	11,738
Deferred revenue	54,891	50,756
Current portion of credit facility	3,060	3,041
Current portion of capital leases	—	10
Total current liabilities	81,992	78,149
Deferred revenue, noncurrent	629	823
Credit facility, noncurrent	3,139	3,911
Other liabilities	9,114	9,199
Total liabilities	94,874	92,082
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, par value $0.01 per share: 10.0 million shares authorized as of March 31, 2015 and December 31, 2014; no shares issued and outstanding as of March 31, 2015 and December 31, 2014	—	—
	859	755

Common stock, par value $0.01 per share: 400.0 million shares authorized; 86.4 million and 76.1 million shares issued; 85.9 million and 75.6 million shares outstanding as of March 31, 2015 and December 31, 2014, respectively (including 0.5 million and 0.6 million shares subject to repurchase, legally issued and outstanding, as of March 31, 2015 and December 31, 2014, respectively)		
Additional paid-in capital	450,027	246,000
Accumulated other comprehensive loss	(928)	(528)
Accumulated deficit	(151,037)	(131,869)
Treasury stock at cost (0.5 million shares as of March 31, 2015 and December 31, 2014)	(652)	(652)
Total stockholders’ equity	298,269	113,706
Total liabilities and stockholders’ equity	$ 393,143	$ 205,788

See Notes to Condensed Consolidated Financial Statements.

4

ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended March 31, 2015	2014
Revenue	$42,234	$25,092
Cost of revenue [1]	14,290	8,995
Gross profit	27,944	16,097
Operating expenses [1]:		
Research and development	13,259	5,178
Sales and marketing	23,403	14,287
General and administrative	10,127	6,384
Total operating expenses	46,789	25,849
Operating loss	(18,845)	(9,752)
Other expense, net	(230)	(458)
Loss before provision for income taxes	(19,075)	(10,210)
Provision for income taxes	93	49
Net loss	(19,168)	(10,259)
Accretion of redeemable convertible preferred stock	—	(12)
Net loss attributable to common stockholders	$(19,168)	$(10,271)
Net loss per share attributable to common stockholders, basic and diluted	$(0.25)	$(0.45)
Weighted-average shares used to compute net loss per share attributable to common stockholders, basic and diluted	76,338	22,762

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

	Three Months Ended March 31, 2015	2014
Cost of revenue	$891	$90
Research and development	4,064	310

Sales and marketing	2,432	490
General and administrative	2,842	934

See Notes to Condensed Consolidated Financial Statements.

ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2015	2014
Net loss	$(19,168)	$(10,259)
Other comprehensive loss, net of tax:		
Net change in unrealized gain on available-for-sale investments	40	(2)
Foreign currency translation loss	(440)	198
Comprehensive loss	$(19,568)	$(10,063)

See Notes to Condensed Consolidated Financial Statements.

ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Cash flows from operating activities		
Net loss	$(19,168)	$(10,259)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,223	1,808
Share-based compensation	10,229	1,824
Other	172	136
Changes in operating assets and liabilities:		
Accounts receivable	(635)	(1,175)
Prepaid expenses and other current assets	(793)	(853)
Other assets and liabilities	(638)	751
Accounts payable	(1,012)	(777)
Accrued liabilities	1,323	1,224
Accrued compensation and related benefits	(2,837)	1,618
Deferred revenue	3,941	4,108
Net cash used in operating activities	(5,195)	(1,595)
Cash flows from investing activities		
Purchases of property and equipment	(3,356)	(3,580)
Internal-use software development costs	(1,317)	(1,801)
Purchases of marketable securities	(14,801)	—
Proceeds from maturities of marketable securities	7,520	1,400
Proceeds from sale of marketable securities	6,141	—
Cash paid for the acquisition of Zopim, net of cash acquired	(548)	(1,784)
Net cash used in investing activities	(6,361)	(5,765)
Cash flows from financing activities		
Proceeds from follow-on public offering, net of issuance costs	190,794	—
Proceeds from exercise of employee stock options	2,938	2,393
Taxes paid related to net share settlement of equity awards	(82)	—
Proceeds from issuance of common stock from employee stock purchase plan	2,468	—
Proceeds from issuance of debt	—	3,940
Principal payments on debt	(753)	(1,762)
Principal payments on capital lease obligations	(10)	(89)
Net cash provided by financing activities	195,355	4,482
Effect of exchange rate changes on cash and cash equivalents	158	8
Net increase (decrease) in cash and cash equivalents	183,957	(2,870)
Cash and cash equivalents at the beginning of period	80,265	53,725
Cash and cash equivalents at the end of period	$264,222	$50,855

Supplemental cash flow data:		
Cash paid for interest and income taxes	$122	$467
Non-cash investing and financing activities:		
Issuance of common stock for the acquisition of Zopim	$—	$10,982
Vesting of early exercised stock options	$311	$412
Purchases of property and equipment in accounts payable and accrued expenses	$14	$3,495
Property and equipment acquired through tenant improvement allowances	$174	$584
Share-based compensation capitalized in internal-use software development costs	$545	$49
Follow-on offering related costs not yet paid for	$605	$—

See Notes to Condensed Consolidated Financial Statements.

ZENDESK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Overview and Basis of Presentation

Company and Background

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

Our mission is to help organizations and their customers build better relationships. We are a software development company that provides a software-as-a-service, or SaaS, customer service platform. Our platform helps organizations engage with people in new ways that foster long-term customer loyalty and satisfaction. We empower organizations to better answer customers' questions, and to solve their problems through the channels that people use every day when seeking help, such as email, chat, voice, social media and websites. Our customer service platform also helps people find answers on their own through knowledge bases and communities, capitalizing on the increasing customer preference for self-service. Our customer engagement capabilities allow organizations to proactively serve their customers, reaching out to those who may need help and soliciting feedback about their experience. The openness of our customer service platform makes it easy for organizations to integrate with their other applications. Our customer service platform consolidates the data from customer interactions and provides organizations with powerful analytics and performance benchmarking.

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

Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP, and applicable rules and regulations of the Securities and Exchange Commission, or SEC, regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2014, filed on February 17, 2015. There have been no changes to our significant accounting policies described in the Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes.

The consolidated balance sheet as of December 31, 2014 included herein was derived from the audited financial statements as of that date. The unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, our comprehensive loss and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2015.

Follow-On Public Offering

In March 2015, we completed a follow-on public offering, in which we issued 8.8 million shares of our common stock at a public offering price of $22.75 per share. We received net proceeds of $190.1 million after deducting underwriting discounts and commissions of $8.7 million and other offering expenses of $0.9 million.

Initial Public Offering and Share-based Compensation

In May 2014, we completed our initial public offering, or IPO, in which we issued and sold 12.8 million shares of common stock at a public offering price of $9.00 per share. We received net proceeds of $103.1 million after deducting underwriting discounts and commissions of $8.1 million and other offering expenses of $3.8 million. Upon the closing of the IPO, all shares of our then-outstanding redeemable convertible preferred stock automatically converted into an aggregate of 34.3 million shares of common stock.

Share-based compensation expense to employees is measured based on the fair value of the awards on the grant date and recognized in our consolidated statements of operations over the period during which the employee is required to perform services in exchange for the award (generally the vesting period of the award). We estimate the fair value of stock options granted using the Black-Scholes option valuation model. We measure the fair value of restricted stock units, or RSUs, based on the fair value of the underlying shares on the date of grant. Compensation expense for awards with only service conditions is recognized over the vesting period of the applicable award using the straight-line method. Compensation expense for awards with both service and performance conditions is recognized over the longer period required to achieve both conditions using the accelerated attribution method.

All RSUs and certain options granted to employees prior to the IPO vest upon the satisfaction of both a service condition and a performance condition. These RSUs and stock options with both a service condition and performance condition are collectively referred to as “Performance Awards” in the following discussion. The service condition for substantially all of these awards is satisfied over four years. The performance condition was satisfied upon the occurrence of a qualifying liquidity event which occurred upon the effectiveness of the registration statement related to our IPO. No share-based compensation expense was recognized for the Performance Awards prior to the IPO as the performance condition had not been deemed probable to have been met. Upon the satisfaction of the performance condition, we recognized a cumulative share-based compensation expense for the portion of the Performance Awards that had met the service condition. The remaining unrecognized share-based compensation expense related to the Performance Awards are being recorded over the remaining requisite service period using the accelerated attribution method, net of estimated forfeitures.

Use of Estimates

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

Significant items subject to such estimates and assumptions include the fair value of our common stock (through the date of our IPO) and share-based awards, fair value of acquired intangible assets, goodwill, unrecognized tax benefits, useful lives of intangible assets and property and equipment, and the capitalization and estimated useful life of our capitalized internal-use software.

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

Concentrations of Risk

At March 31, 2015, there were no customers that represented more than 10% of our accounts receivable balance. At March 31, 2014, one customer represented 14% and a second customer represented 12% of our total accounts receivable balance. There were no customers that individually exceeded 10% of our revenue during the three months ended March 31, 2015 or 2014.

Recently Issued and Adopted Accounting Pronouncements

On May 28, 2014, the FASB issued ASU 2014-09 regarding ASC Topic 606 “Revenue from Contracts with Customers.” This ASU provides principles for recognizing revenue to which an entity expects to be entitled for the transfer of promised goods or services to customers. This ASU is expected to be effective no earlier than our fiscal year beginning January 1, 2017. Early adoption is not permitted. We are currently evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

Note 2. Acquisition

On March 21, 2014, we completed the acquisition of Zopim Technologies Pte Ltd., or Zopim, a software development company that provides a SaaS live chat service. As of December 31, 2014, we finalized our purchase accounting after adjustments were made to the preliminary purchase price allocation. The total adjusted acquisition date fair value of consideration transferred was $15.8 million ($4.9 million of cash and $10.9 million of our common stock), which included $1.1 million of cash and $2.4 million of common stock consideration that was held back between 12 and 18 months as partial security for standard indemnification obligations. In the three months ended March 31, 2015, we released $0.5 million of cash and $1.2 million of common stock consideration that was held back, based on the fair value of our common stock on the date of the acquisition. The total adjusted purchase price was allocated to assets acquired and liabilities assumed as set forth below (in thousands). The excess of the purchase price over the net assets acquired was recorded as goodwill. Goodwill generated from the acquisition is attributable to expected synergies from future growth and potential future monetization opportunities, and is not deductible for tax purpose.

Net tangible liabilities assumed	$(385)
Intangible assets	6,560
Goodwill	9,594
Total purchase price	$15,769

In connection with the acquisition, we also established a retention plan pursuant to which we issued RSUs for 0.9 million shares of our common stock, which vest in three annual installments from the date of acquisition. In addition, we agreed to pay cash in an aggregate amount of $3.0 million in two annual installments from the date of acquisition to Zopim employees in connection with their continued employment, which is recorded as compensation expense over the associated service periods of such employees. In the three months ended March 31, 2015, RSUs for 0.3 million shares of our common stock became vested pursuant to the terms of the retention plan, and we paid the first installment of the cash retention bonus in the amount of $1.5 million.

Pro forma revenue and results of operations have not been presented because the historical results of Zopim were not material to our consolidated financial statements in any period presented.

Note 3. Fair Value Measurements

The following tables present information about our financial assets measured at fair value on a recurring basis as of March 31, 2015 and December 31, 2014 based on the three-tier fair value hierarchy (in thousands):

	Fair Value Measurement at March 31, 2015		
	Level 1	Level 2	Total
Description			
Corporate securities	$—	$38,097	$38,097
Money market funds	20,491	—	20,491
Commercial paper	—	7,991	7,991
Asset-backed securities	—	5,069	5,069
U.S. treasury securities	—	1,199	1,199
Total	$20,491	$52,356	$72,847
Included in cash and cash equivalents			$20,491
Included in marketable securities			$52,356

	Fair Value Measurement at December 31, 2014		
	Level 1	Level 2	Total
Description			
Corporate securities	$—	$40,345	$40,345
Money market funds	21,382	—	21,382
Asset-backed securities	—	5,080	5,080
Commercial paper	—	3,993	3,993
U.S. treasury securities	—	1,991	1,991

Total	$21,382	$51,409	$72,791
Included in cash and cash equivalents			$21,382
Included in marketable securities			$51,409

Gross unrealized gains or losses for cash equivalents and available-for-sale marketable securities as of March 31, 2015 and December 31, 2014 were not material. As of March 31, 2015 and December 31, 2014, there were no securities that were in an unrealized loss position for more than 12 months.

The following table classifies our available-for-sale marketable securities by contractual maturities as of March 31, 2015 and December 31, 2014 (in thousands):

	March 31, 2015	December 31, 2014
Due in one year	$44,855	$ 42,204
Due in one to five years	7,501	9,205
Total	$52,356	$ 51,409

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. Based on borrowing rates available to us for loans with similar terms and maturities, the carrying value of borrowings approximates fair value or Level 2 within the fair value hierarchy.

There were no transfers between fair value measurement levels during the three months ended March 31, 2015.

Note 4. Property and Equipment

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

	March 31, 2015	December 31, 2014
Capitalized internal-use software	$23,305	$18,541
Furniture and fixtures	4,619	4,524
Hosting equipment	16,642	14,085
Computer equipment and software	4,335	4,310
Leasehold improvements	15,439	15,144
Construction in progress	757	3,546
Total	65,097	60,150
Less: accumulated depreciation and amortization	(21,746)	(18,255)
Property and equipment, net	$43,351	$41,895

Depreciation expense was $2.3 million and $1.0 million for the three months ended March 31, 2015 and 2014, respectively.

We capitalized $1.9 million and $1.8 million in internal-use software during the three months ended March 31, 2015 and 2014, respectively. Included in the capitalized development costs are $0.5 million and $49,000 in share-based compensation costs for the three months ended March 31, 2015 and 2014, respectively. Amortization expense of capitalized internal-use software totaled $1.5 million and $0.7 million for the three months ended March 31, 2015 and 2014, respectively. The carrying value of capitalized internal-use software at March 31, 2015 and December 31, 2014 was $14.0 million and $13.6 million, respectively, including $0.6 million and $3.5 million in construction in progress, respectively.

Note 5. Goodwill and Purchased Intangible Assets

The changes in the carrying amount of goodwill for the three months ended March 31, 2015 are as follows (in thousands):

Balance as of December 31, 2014	$9,240
Foreign currency translation adjustments	(306)
Balance as of March 31, 2015	$8,934

Purchased intangible assets subject to amortization as of March 31, 2015 and December 31, 2014 consist of the following (in thousands).

	March 31, 2015				
	Cost	Accumulated Amortization	Foreign Currency Translation Adjustment	Net	Remaining Useful Life (In years)
Developed technology	$5,200	$ (1,526)	$ (253)	$3,421	2.5
Customer relationships	1,300	(334)	(66)	900	3.0
Trade name	60	(60)	—	—	—
	$6,560	$ (1,920)	$ (319)	$4,321	

11

	December 31, 2014				
	Cost	Accumulated Amortization	Foreign Currency Translation Adjustment	Net	Remaining Useful Life (In years)
Developed technology	$5,200	$ (1,118)	$ (191)	$3,891	2.7
Customer relationships	1,300	(244)	(48)	1,008	3.2
Trade name	60	(45)	(2)	13	0.2
	$6,560	$ (1,407)	$ (241)	$4,912	

Amortization expense of purchased intangible assets for the three months ended March 31, 2015 and 2014 was $0.4 million and $52,000, respectively.

Estimated future amortization expense as of March 31, 2015 is as follows (in thousands):

Remainder of 2015	$1,271
2016	1,686
2017	1,298
2018	