

COMMVault SYSTEMS INC
Form 10-Q
October 30, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: September 30, 2014

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 1-33026

CommVault Systems, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

22-3447504
(I.R.S. Employer
Identification No.)

2 Crescent Place
Oceanport, New Jersey
(Address of principal executive offices)
(732) 870-4000
(Registrant's telephone number, including area code)

07757
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by the Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such 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 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 registrant was required to submit and post such files.) Yes 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 definition of "accelerated filer and large accelerated filer" in rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if 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

As of October 21, 2014, there were 45,764,460 shares of the registrant's common stock, \$0.01 par value, outstanding.

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Consolidated Balance Sheets

(In thousands, except per share data)

	September 30, 2014 (unaudited)	March 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$364,574	\$457,733
Short-term investments	49,969	24,976
Trade accounts receivable, less allowance for doubtful accounts of \$108 at September 30, 2014 and \$111 at March 31, 2014	101,081	118,527
Prepaid expenses and other current assets	16,652	11,329
Deferred tax assets, net	18,123	17,966
Total current assets	550,399	630,531
Deferred tax assets, net	28,927	28,737
Property and equipment, net	121,186	88,901
Other assets	7,869	7,215
Total assets	\$708,381	\$755,384
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$1,325	\$1,218
Accrued liabilities	65,297	76,166
Deferred revenue	171,971	166,143
Total current liabilities	238,593	243,527
Deferred revenue, less current portion	46,829	43,432
Other liabilities	4,270	5,847
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, \$0.01 par value: 50,000 shares authorized, no shares issued and outstanding at September 30, 2014 and March 31, 2014	—	—
Common stock, \$0.01 par value: 250,000 shares authorized, 45,577 shares and 47,094 shares issued and outstanding at September 30, 2014 and March 31, 2014, respectively	456	471
Additional paid-in capital	509,954	481,083
Accumulated deficit	(89,383	) (18,059
Accumulated other comprehensive loss	(2,338	) (917
Total stockholders' equity	418,689	462,578
Total liabilities and stockholders' equity	\$708,381	\$755,384
See accompanying unaudited notes to consolidated financial statements		

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CommVault Systems, Inc.
Consolidated Statements of Income
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Software	\$69,415	\$70,831	\$141,473	\$136,130
Services	81,729	71,032	162,314	140,141
Total revenues	151,144	141,863	303,787	276,271
Cost of revenues:				
Software	657	636	1,247	1,291
Services	19,629	17,520	39,966	34,643
Total cost of revenues	20,286	18,156	41,213	35,934
Gross margin	130,858	123,707	262,574	240,337
Operating expenses:				
Sales and marketing	83,697	67,147	164,008	134,348
Research and development	15,835	13,344	30,875	26,195
General and administrative	18,742	15,298	35,247	29,026
Depreciation and amortization	1,680	1,498	3,326	2,951
Total operating expenses	119,954	97,287	233,456	192,520
Income from operations	10,904	26,420	29,118	47,817
Interest expense	(218	) —	(218) —
Interest income	195	213	390	455
Income before income taxes	10,881	26,633	29,290	48,272
Income tax expense	4,385	9,279	10,065	17,456
Net income	\$6,496	\$17,354	\$19,225	\$30,816
Net income per common share:				
Basic	\$0.14	\$0.37	\$0.42	\$0.66
Diluted	\$0.14	\$0.35	\$0.40	\$0.62
Weighted average common shares outstanding:				
Basic	45,437	46,910	45,750	46,727
Diluted	47,166	49,745	47,536	49,533

See accompanying unaudited notes to consolidated financial statements

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CommVault Systems, Inc.

Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$6,496	\$17,354	\$19,225	\$30,816
Other comprehensive income (loss):				
Foreign currency translation adjustment	(2,162)	844	(1,421)	(772)
Comprehensive income	\$4,334	\$18,198	\$17,804	\$30,044

See accompanying unaudited notes to consolidated financial statements

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CommVault Systems, Inc.
Consolidated Statement of Stockholders' Equity
(In thousands)
(Unaudited)

	Common Stock		Additional	Accumulated	Accumulated	Total
	Shares	Amount	Paid – In Capital	Deficit	Other Comprehensive Loss	
Balance as of March 31, 2014	47,094	\$471	\$481,083	\$(18,059)	\$ (917)	\$462,578
Stock-based compensation			29,487			29,487
Tax benefits relating to stock-based payments			3,388			3,388
Share issuances related to stock-based compensation	622	6	10,511			10,517
Repurchase of common stock	(2,139)	(21)	(14,515)	(90,549)		(105,085)
Net income				19,225		19,225
Other comprehensive income (loss)					(1,421)	(1,421)
Balance as of September 30, 2014	45,577	\$456	\$509,954	\$(89,383)	\$ (2,338)	\$418,689

See accompanying unaudited notes to consolidated financial statements

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CommVault Systems, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended September	
	30,	
	2014	2013
Cash flows from operating activities		
Net income	\$ 19,225	\$ 30,816
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,446	3,017
Noncash stock-based compensation	29,487	20,290
Excess tax benefits from stock-based compensation	(3,387	) (16,843
Deferred income taxes	(465	) (1,208
Changes in operating assets and liabilities:		
Trade accounts receivable	16,188	(1,402
Prepaid expenses and other current assets	(7,762	) 2,108
Other assets	(105	) 197
Accounts payable	313	(138
Accrued liabilities	(1,011	) 5,524
Deferred revenue	13,309	6,760
Other liabilities	(1,612	) (65
Net cash provided by operating activities	67,626	49,056
Cash flows from investing activities		
Purchase of short-term investments	(43,976	) (22,982
Proceeds from maturity of short-term investments	18,983	1,948
Purchases for corporate campus headquarters	(35,426	) (23,872
Purchase of property and equipment	(2,456	) (2,586
Net cash used in investing activities	(62,875	) (47,492
Cash flows from financing activities		
Repurchase of common stock	(105,085) —
Debt issuance costs	(1,175) —
Proceeds from the exercise of stock options and the Employee Stock Purchase Plan	10,517	9,670
Excess tax benefits from stock-based compensation	3,387	16,843
Net cash provided by (used in) financing activities	(92,356	) 26,513
Effects of exchange rate — changes in cash	(5,554	) 126
Net increase (decrease) in cash and cash equivalents	(93,159	) 28,203
Cash and cash equivalents at beginning of period	457,733	433,964
Cash and cash equivalents at end of period	\$ 364,574	\$ 462,167
Supplemental disclosures of cash flow information		
Purchases for corporate campus headquarters in accounts payable and accrued expenses	\$ 4,659	\$ 6,369
See accompanying unaudited notes to consolidated financial statements		

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited

(In thousands, except per share data)

1. Basis of Presentation

CommVault Systems, Inc. and its subsidiaries (“CommVault” or the “Company”) is a leading provider of data and information management software applications and related services. The Company develops, markets and sells a suite of software applications and services, primarily in North America, Europe, Australia and Asia, that provides its customers with high-performance data protection, including backup and recovery; data migration and archiving; snapshot management and replication of data; integrated source, and target data deduplication; eDiscovery and compliance solutions; self-service access; a secure virtual repository using Simpana ContentStore; enterprise-wide search capabilities; protection, recovery and discovery of data in virtual server and cloud environments; and robust built-in analytics and troubleshooting tools. The Company’s unified suite of data and information management software applications, which is sold under the Simpana brand, shares an underlying architecture that has been developed to minimize the cost and complexity of managing data on globally distributed and networked storage infrastructures. The Company also provides its customers with a broad range of professional and customer support services.

The consolidated financial statements as of September 30, 2014 and for the three and six months ended September 30, 2014 and 2013 are unaudited, and in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the results for the interim periods. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“U.S. GAAP”) for complete financial statements and should be read in conjunction with the financial statements and notes in the Company’s Annual Report on Form 10-K for fiscal 2014. The results reported in these financial statements should not necessarily be taken as indicative of results that may be expected for the entire fiscal year.

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments and estimates that affect the amounts reported in the Company’s consolidated financial statements and the accompanying notes. The Company bases its estimates and judgments on historical experience and on various other assumptions that it believes are reasonable under the circumstances. The amounts of assets and liabilities reported in the Company’s balance sheets and the amounts of revenues and expenses reported for each of its periods presented are affected by estimates and assumptions, which are used for, but not limited to, the accounting for revenue recognition, allowance for doubtful accounts, income taxes and related reserves, stock-based compensation and accounting for research and development costs. Actual results could differ from those estimates.

2. Summary of Significant Accounting Policies

There have been no significant changes in the Company’s accounting policies during the six months ended September 30, 2014 as compared to the significant accounting policies described in its Annual Report on Form 10-K for the year ended March 31, 2014.

Revenue Recognition

The Company derives revenues from two primary sources: software licenses and services. Services include customer support, consulting, assessment and design services, installation services and training. A typical sales arrangement includes both licenses and services.

For sales arrangements involving multiple elements, the Company recognizes revenue using the residual method. Under the residual method, the Company allocates and defers revenue for the undelivered elements based on fair value and recognizes the difference between the total arrangement fee and the amount deferred for the undelivered elements as revenue. The determination of fair value of the undelivered elements in multiple-element arrangements is based on the price charged when such elements are sold separately, which is commonly referred to as vendor-specific objective-evidence, or VSOE.

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

The Company's software licenses typically provide for a perpetual right to use the Company's software and are sold on a capacity basis, on a per-copy basis, or as site licenses. Software licenses sold on a capacity basis provide the customer with unlimited licenses of specified software products based on a defined level of terabytes of data under management. Site licenses give the customer the additional right to deploy the software on a limited basis during a specified term. The Company recognizes software revenue through direct sales channels upon receipt of a purchase order or other persuasive evidence and when all other basic revenue recognition criteria are met as described below. The Company recognizes software revenue through all indirect sales channels on a sell-through model. A sell-through model requires that the Company recognize revenue when the basic revenue recognition criteria are met as described below and these channels complete the sale of the Company's software products to the end-user. Revenue from software licenses sold through an original equipment manufacturer partner is recognized upon the receipt of a royalty report or purchase order from that original equipment manufacturer partner.

Services revenue includes revenue from customer support and other professional services. Customer support includes software updates on a when-and-if-available basis, telephone support, integrated web-based support and bug fixes or patches. Customer support revenue is recognized ratably over the term of the customer support agreement, which is typically one year. To determine the price for the customer support element when sold separately, the Company primarily uses historical renewal rates. Historical renewal rates are supported by performing an analysis in which the Company segregates its customer support renewal contracts into different classes based on specific criteria including, but not limited to, the dollar amount of the software purchased, the level of customer support being provided and the distribution channel. As a result of this analysis, the Company has concluded that it has established VSOE for the different classes of customer support when the support is sold as part of a multiple-element sales arrangement. The Company's determination of fair value for customer support has not changed for the periods presented.

The Company's other professional services include consulting services, implementation and post-deployment services and education services. Other professional services provided by the Company are not mandatory and can also be performed by the customer or a third-party. In addition to a signed purchase order, the Company's consulting services and implementation and post-deployment services are, in some cases, evidenced by a Statement of Work, which defines the specific scope of such services to be performed when sold and performed on a stand-alone basis or included in multiple-element sales arrangements. Revenues from consulting services and implementation and post-deployment services are based upon a daily or weekly rate and are recognized when the services are completed. Educational services include courses taught by the Company's instructors or third-party contractors either at one of the Company's facilities or at the customer's site. Educational services fees are recognized as revenue after the course has been provided. Based on the Company's analysis of such other professional services transactions sold on a stand-alone basis, the Company has concluded it has established VSOE for such other professional services when sold in connection with a multiple-element sales arrangement. The Company generally performs its other professional services within 90 days of entering into an agreement. The Company's determination of fair value for other professional services has not changed for the periods presented.

The Company has analyzed all of the undelivered elements included in its multiple-element sales arrangements and determined that VSOE of fair value exists to allocate revenues to services. Accordingly, assuming all basic revenue recognition criteria are met, software revenue is recognized upon delivery of the software license using the residual method.

The Company considers the four basic revenue recognition criteria for each of the elements as follows:

Persuasive evidence of an arrangement with the customer exists. The Company's customary practice is to require a purchase order and, in some cases, a written contract signed by both the customer and the Company, or other persuasive evidence that an arrangement exists prior to recognizing revenue related to an arrangement.

Delivery or performance has occurred. The Company's software applications are either physically or electronically delivered to customers with standard transfer terms such as FOB shipping point. Software and/or software license keys for add-on orders or software updates are typically delivered in an electronic format. If products that are essential to the functionality of the delivered software in an arrangement have not been delivered, the Company does not consider delivery to have occurred. Services revenue is recognized when the services are completed, except for customer support, which is recognized ratably over the term of the customer support agreement, which is typically one year.

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

Vendor's fee is fixed or determinable. The fee customers pay for software applications, customer support and other professional services is negotiated at the outset of a sales arrangement. The fees are therefore considered to be fixed or determinable at the inception of the arrangement. The Company evaluates instances when extended payment terms are granted to determine if revenue should be deferred until payment becomes due.

Collection is probable. Probability of collection is assessed on a customer-by-customer basis. Each new customer undergoes a credit review process to evaluate its financial position and ability to pay. If the Company determines from the outset of an arrangement that collection is not probable based upon the review process, revenue is recognized at the earlier of when cash is collected or when sufficient credit becomes available, assuming all of the other basic revenue recognition criteria are met.

The Company's sales arrangements generally do not include acceptance clauses. However, if an arrangement does include an acceptance clause, revenue for such an arrangement is deferred and recognized upon acceptance.

Acceptance occurs upon the earliest of receipt of a written customer acceptance, waiver of customer acceptance or expiration of the acceptance period.

Concentration of Credit Risk

The Company grants credit to customers in a wide variety of industries worldwide and generally does not require collateral. Credit losses relating to these customers have been minimal.

Sales through the Company's distribution agreement with Arrow Enterprise Computing Solutions, Inc. ("Arrow") totaled 34% and 31% of total revenues for the six months ended September 30, 2014 and 2013, respectively. Arrow accounted for approximately 43% of total accounts receivable as of September 30, 2014 and 41% of total accounts receivable as of March 31, 2014.

The Company has an original equipment manufacturer agreement with Hitachi Data Systems ("HDS") for them to market, sell and support our software applications and services on a stand-alone basis and/or incorporate our software applications into their own hardware products. HDS accounted for 11% of total revenues for the six months ended September 30, 2014. HDS accounted for 14% of total accounts receivable as of September 30, 2014.

Deferred Revenue

Deferred revenues represent amounts collected from, or invoiced to, customers in excess of revenues recognized. This results primarily from the billing of annual customer support agreements and billings for other professional services fees that have not yet been performed by the Company and receipt of license fees that are deferred due to one of the revenue recognition criteria not being met. The value of deferred revenues will increase or decrease based on the timing of invoices and recognition of revenue. The Company expenses internal direct and incremental costs related to contract acquisition and origination as incurred.

Deferred revenue consists of the following:

	September 30, 2014	March 31, 2014
Current:		
Deferred software revenue	\$947	\$666
Deferred services revenue	171,024	165,477
	\$171,971	\$166,143
Non-current:		
Deferred services revenue	\$46,829	\$43,432
Total Deferred Revenue	\$218,800	\$209,575

Fair Value of Financial Instruments

The carrying amounts of the Company's cash and cash equivalents, accounts receivable and accounts payable approximate their fair values due to the short-term maturity of these instruments. As of September 30, 2014, and

March 31, 2014 the Company's short-term investments balance consisted of U.S. Treasury Bills.

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for such asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value should maximize the use of observable inputs and minimize the use of unobservable inputs. To measure fair value, the Company uses the following fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data by correlation or other means.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table summarizes the composition of the Company's financial assets measured at fair value on a recurring basis at September 30, 2014 and March 31, 2014:

September 30, 2014	Level 1	Level 2	Level 3	Total
Cash equivalents	\$226,313	—	—	\$226,313
Short-term Investments	\$—	49,987	—	\$49,987
March 31, 2014	Level 1	Level 2	Level 3	Total
Cash equivalents	\$326,952	—	—	\$326,952
Short-term Investments	\$—	24,993	—	\$24,993

Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." This amendment provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. This amendment will be effective for the Company's fiscal year beginning April 1, 2017. Early adoption is not permitted. The Company is currently evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

There have been no other accounting pronouncements issued but not yet adopted by the Company which are expected to have a material impact on the Company's financial position, results of operations or cash flows.

3. Property and Equipment

Property and equipment consist of the following:

	September 30, 2014	March 31, 2014
Construction in process	\$112,461	\$79,182
Computers, servers and other equipment	29,019	27,827
Leasehold improvements	8,815	8,911
Furniture and fixtures	2,408	2,409
Purchased software	2,365	2,291
	155,068	120,620
Less: Accumulated depreciation and amortization	(33,882)	(31,719)
	\$121,186	\$88,901

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

Construction in process at September 30, 2014 is comprised of the purchase of land and related design and construction cost for the Company's planned corporate campus headquarters, which the Company expects to finalize over approximately the next six months. The value of land included in construction in process at September 30, 2014 is \$5,915.

4. Net Income per Common Share

Basic net income per common share is computed by dividing net income by the weighted average number of common shares during the period. Diluted net income per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options, vesting of restricted stock units and shares to be purchased under the Employee Stock Purchase Plan. The dilutive effect of such potential common shares is reflected in diluted earnings per share by application of the treasury stock method.

The following table sets forth the computation of basic and diluted net income per common share:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$6,496	\$17,354	\$19,225	\$30,816
Basic net income per common share:				
Basic weighted average shares outstanding	45,437	46,910	45,750	46,727
Basic net income per common share	\$0.14	\$0.37	\$0.42	\$0.66
Diluted net income per common share:				
Basic weighted average shares outstanding	45,437	46,910	45,750	46,727
Dilutive effect of stock options, restricted stock units, and employee stock purchase plan	1,729	2,835	1,786	2,806
Diluted weighted average shares outstanding	47,166	49,745	47,536	49,533
Diluted net income per common share	\$0.14	\$0.35	\$0.40	\$0.62

The diluted weighted average shares outstanding in the table above exclude outstanding stock options, restricted stock units and shares to be purchased under the employee stock purchase plan totaling approximately 2,874 and 316 for the three months ended September 30, 2014 and 2013, respectively, and 2,807 and 311 for the six months ended September 30, 2014 and 2013, respectively, because the effect would have been anti-dilutive.

5. Commitments and Contingencies

In the normal course of its business, the Company may be involved in various claims, negotiations and legal actions. As of September 30, 2014, the Company is not aware of any asserted or unasserted claims, negotiations and legal actions for which a loss is considered reasonably possible of occurring and would require disclosure under the guidance.

On September 10, 2014, a purported class action complaint was filed in the United States District Court for the District of New Jersey against the Company, the Chief Executive Officer and the Chief Financial Officer. The case is captioned Town of Davie Police Pension Plan vs. CommVault Systems, Inc. (Case No. 3:14-cv-05628-JAP-LHG). The suit alleges that the defendants made materially false and misleading statements, or failed to disclose material facts, regarding the Company's financial results, business, operations and prospects in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The suit asserts claims covering an alleged class period from May 15, 2013 through April 24, 2014. It is purportedly brought on behalf of purchasers of the Company's common stock during that period, and seeks compensatory damages, costs and expenses, as well as equitable or other relief. At this time, the Company is unable to predict the outcome of this matter and cannot currently estimate a range of any possible losses that it may experience. Accordingly, the Company is unable at this time to estimate the effects of this lawsuit on its financial condition, results of operations, or cash flows. As of

September 30, 2014 the Company has not recorded a reserve for this matter.

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

6. Revolving Credit Facility

On June 30, 2014 the Company entered into a five-year \$250,000 revolving credit facility (the "Credit Facility"). The Credit Facility is available for share repurchases, general corporate purposes, and letters of credit. The Credit Facility contains financial maintenance covenants including a leverage ratio and interest coverage ratio. The Credit Facility also contains certain customary events of default which would permit the lenders to, among other things, declare all loans then outstanding to be immediately due and payable if such default is not cured within applicable grace periods. The Credit Facility also limits the Company's ability to incur certain additional indebtedness, create or permit liens on assets, make acquisitions, make investments, loans or advances, sell or transfer assets, pay dividends or distributions, and engage in certain transactions with foreign affiliates. Outstanding borrowings under the Credit Facility accrue interest at an annual rate equal to London Interbank Offered Rate plus 1.50% subject to increases based on the Company's actual leverage. The unused balance on the Credit Facility is also subject to a 0.25% annual interest charge subject to increases based on the Company's actual leverage. As of September 30, 2014, there were no borrowings under the Credit Facility and the Company was in compliance with all covenants.

The Company has deferred the expense related to debt issuance costs, which are classified as Other Assets, and will amortize the costs into interest expense over the term of the Credit Facility. Unamortized amounts at September 30, 2014 were \$1,116. The amortization of debt issuance costs was \$59 in the three and six months ended September 30, 2014 and is included in Interest expense.

7. Capitalization

During the six months ended September 30, 2014, the Company repurchased \$105,085 of common stock (2,139 shares) under its share repurchase program. As of September 30, 2014, \$150,000 remained in the stock repurchase authorization program through March 31, 2016.

8. Stock Plans

The following summarizes the activity by award type for the Company's two stock incentive plans, the 1996 Stock Option Plan and the 2006 Long-Term Stock Incentive Plan, for the six months ended September 30, 2014:

Options	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding as of March 31, 2014	6,388	\$39.03		
Options granted	140	50.46		
Options exercised	(347)	) 19.24		
Options forfeited	(39)	) 67.21		
Options expired	(1)	) 54.96		
Outstanding as of September 30, 2014	6,141	\$40.22	6.04	\$110,686
Vested or expected to vest as of September 30, 2014	6,078	\$39.71	6.00	\$110,638
Exercisable as of September 30, 2014	3,896	\$23.90	4.66	\$106,318

The weighted average fair value of stock options granted was \$21.85 per option and \$21.22 per option during the three and six months ended September 30, 2014, respectively, and \$32.48 per option and \$29.32 per option during the three and six months ended September 30, 2013, respectively. The total intrinsic value of options exercised was \$3,682 and \$10,945 for the three and six months ended September 30, 2014, respectively, and \$6,613 and \$9,670 for the three and six months ended September 30, 2013. The Company's policy is to issue new shares upon exercise of options as the Company does not hold shares in treasury.

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

The assumptions used in the Black-Scholes option-pricing model are as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Dividend yield	None	None	None	None
Expected volatility	43-47%	44-45%	43%-47%	44%-47%
Weighted average expected volatility	46%	44%	46%	45%
Risk-free interest rates	1.58-2.18%	1.43%-1.65%	1.57%-2.18%	0.70%-1.65%
Weighted average expected life (in years)	5.5	4.6	5.2	4.6

Restricted stock unit activity for the six months ended September 30, 2014 is as follows:

	Number of Awards	Weighted Average Grant Date Fair Value
Non-vested Restricted Stock Units		
Non-vested as of March 31, 2014	1,202	\$65.63
Awarded	123	51.56
Vested	(180)	45.20
Forfeited	(39)	64.94
Non-vested as of September 30, 2014	1,106	\$67.40

The weighted average fair value of restricted stock units awarded was \$51.24 per unit and \$51.56 per unit during the three and six months ended September 30, 2014, respectively, and \$84.85 per unit and \$78.42 per unit during the three and six months ended September 30, 2013, respectively.

The following table presents the stock-based compensation expense included in cost of services revenue, sales and marketing, research and development and general and administrative expenses for the three and six months ended September 30, 2014 and 2013.

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Cost of services revenue	\$732	\$293	\$1,401	\$591
Sales and marketing	6,568	4,085	12,744	8,346
Research and development	1,403	939	2,717	1,896
General and administrative	6,369	5,465	12,625	9,457
Stock-based compensation expense	\$15,072	\$10,782	\$29,487	\$20,290

As of September 30, 2014, there was approximately \$108,925 of unrecognized stock-based compensation expense, net of estimated forfeitures, related to non-vested stock option and restricted stock unit awards that is expected to be recognized over a weighted average period of 2.32 years. To the extent the actual forfeiture rate is different from what the Company has estimated, stock-based compensation related to these awards will be different from the Company's current estimate.

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

Employee Stock Purchase Plan

The Employee Stock Purchase Plan (the "Purchase Plan") is a shareholder approved plan under which substantially all employees may purchase the Company's common stock through payroll deductions at a price equal to 85% of the lower of the fair market values of the stock as of the beginning or the end of six-month offering periods. An employee's payroll deductions under the Purchase Plan are limited to 10% of the employee's salary and employees may not purchase more than \$25 of stock during any calendar year. The first purchase date of the Purchase Plan was August 1, 2014 and approximately 95 shares were purchased in exchange for \$3,838 of proceeds. As of September 30, 2014, 2,906 shares were reserved for future issuance under the Purchase Plan. The Purchase Plan is considered compensatory and the fair value of the discount and look back provision are estimated using the Black-Scholes formula and recognized over the six month withholding period prior to purchase. The total expense associated with the Purchase Plan for the three and six months ended September 30, 2014 is \$767 and \$1,376, respectively. These expenses are included in the summary of stock-based compensation expense above. There was no expenses in the prior year related to the plan. As of September 30, 2014, there was approximately \$1,133 of unrecognized cost related to the current purchase period of our Employee Stock Purchase Plan.

9. Income Taxes

Income Tax Expense

Income tax expense was \$4,385 and \$10,065 in the three and six months ended September 30, 2014, respectively with an effective tax rate of 40% and 34% in the three and six months ended September 30, 2014, respectively. The effective rate in the three months ended September 30, 2014 is higher than the federal statutory rate due to state income taxes and permanent differences in both the United States and foreign jurisdictions. These items were partially offset by foreign tax credits and domestic production activities deductions. The effective rate in the six months ended September 30, 2014 is lower than the federal statutory rate due to the recognition of certain previously unrecognized tax benefits and tax benefits from foreign tax credits and domestic production activities deductions. These benefits were partially offset by state income taxes and permanent differences in both the United States and foreign jurisdictions.

Income tax expense was \$9,279 and \$17,456 in the three and six months ended September 30, 2013, respectively with effective tax rate of 35% and 36% in the three and six months ended September 30, 2013, respectively. The effective rate in the three and six months ended September 30, 2013 approximates the federal statutory rate but is impacted by state income taxes and permanent differences in both the United States and foreign jurisdictions partially offset by income tax benefits from research and development tax credits, foreign tax credits, and domestic production activities deductions.

Unrecognized Tax Benefits

The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations in each of its tax jurisdictions. The number of years with open tax audits varies depending on the tax jurisdiction. A number of years may lapse before a particular matter is audited and finally resolved. A reconciliation of the beginning and ending amounts of unrecognized tax benefits is as follows:

Balance as of March 31, 2014	\$4,113	
Additions for tax positions related to fiscal 2015	147	
Additions for tax positions related to prior years	—	
Settlements and effective settlements with tax authorities and remeasurements	(1,435)
Reductions related to the expiration of statutes of limitations	—	
Foreign currency translation adjustment	(2)
Balance as of September 30, 2014	\$2,823	

All of the Company's unrecognized tax benefits would favorably impact the effective tax rate if they were recognized. Components of the reserve are classified as either current or long-term in the Consolidated Balance Sheet based on

when the Company expects each of the items to be settled. Accordingly, the Company has recorded its unrecognized tax benefits of \$2,823 and \$4,113 and the related accrued interest and penalties of \$342 and \$555 in Other Liabilities on the Consolidated Balance Sheet at September 30, 2014 and March 31, 2014, respectively. Interest and penalties related to unrecognized tax benefits are recorded in income tax expense.

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CommVault Systems, Inc

Notes to Consolidated Financial Statements - Unaudited (continued)

(In thousands, except per share data)

Other Tax Items

Excess tax benefits related to share-based payments are credited to equity. When determining this excess tax benefit, the Company elected to follow the tax law approach. As a result, the Company's excess tax benefit which was recorded to equity was approximately \$3,388 and \$16,897 for the six months ended September 30, 2014 and 2013, respectively. The Company conducts business globally and as a result, files income tax returns in the United States and in various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States, Australia, Canada, Germany, Netherlands and United Kingdom. The Company's Federal income tax returns for fiscal 2012 and 2013 are currently under audit. Additionally, the Company's New Jersey tax returns for fiscal 2010 through 2013 are currently under audit.

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

You should read the following discussion and analysis along with our consolidated financial statements and the related notes included elsewhere in this quarterly report on Form 10-Q. The statements in this discussion regarding our expectations of our future performance, liquidity and capital resources, and other non-historical statements are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described under "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

Overview

We are a leading provider of data and information management software applications and related services in terms of product breadth and functionality and market penetration. We develop, market and sell a unified suite of data and information management software applications under the Simpana® brand. Simpana software is built from the ground up on a single platform and unified code base for integrated data and information management. The Simpana platform contains licensable modules that work together seamlessly, sharing a single code and common function set to deliver Backup and Recovery, Archive, Replication, eDiscovery and Analytic capabilities across physical, virtual and cloud environments. With a single platform approach, Simpana software is specifically designed to protect, manage and access data throughout its lifecycle in less time, at lower cost and with fewer resources than alternative solutions. Our product features and capabilities enable our customers to deploy solutions for data protection, business continuance, corporate compliance and centralized management and reporting. We also provide our customers with a broad range of professional services that are delivered by our worldwide support and field operations. As of September 30, 2014, we had licensed our software applications to over 20,000 registered customers.

In February 2013, our CommVault Simpana 10.0 software suite ("Simpana 10") was made available for public release. We believe Simpana 10 extends our data protection and archiving leadership to deliver secure, self-service access from mobile devices, speed the adoption of cloud computing and extract value from Big Data. Simpana 10 includes major technology advancements such as Enhanced IntelliSnap™ snapshot management; Simpana OnePass™ with Exchange; tighter integration with Microsoft Hyper-V, VMware vSphere 5.1 and vCloud Director 5.1; workflow automation; fourth-generation parallel deduplication; and customizable web-based reporting, dashboards and cloud-based analytics. Our Simpana 10 architecture efficiently stores all protected data in a virtual repository, called ContentStore, and opens access to simplify the way end users search, analyze and repurpose data across an enterprise. Our software licenses typically provide for a perpetual right to use our software and are sold on a capacity basis, on a per-copy basis or as site licenses. During the six months ended September 30, 2014, approximately 81% of software license revenue was sold on a capacity basis. Capacity based software licenses provide our customers with unlimited licenses of specified software products based on a defined level of terabytes of data under management. As a result, when we sell our platform through a capacity license, many of the various Simpana functionalities are bundled into one capacity based price. We anticipate that capacity based licenses will continue to account for the majority of our software license revenue for the foreseeable future.

Historically, an insignificant amount of our revenue has been sold under subscription, or term based, license arrangements. In these arrangements the customer has the right to use the software on either a capacity basis or per-copy basis over a designated period of time. Revenue in these arrangements is recognized ratably over the term of the agreement. Over the next several years we expect revenue from these types of arrangements to become a more significant portion of our total revenue.

The industry in which we currently operate continues to go through accelerating changes as the result of compounding data growth and the introduction of new technologies. We are continuing to pursue an aggressive product development program in both data and information management solutions. Our data management solutions include not only traditional backup, but also new innovations in de-duplication, data movement, virtualization, snap-based backups and enterprise reporting. Our information management innovations are primarily in the areas of archiving, eDiscovery, records management, governance, operational reporting and compliance. We remain focused on both the data and information management trends in the marketplace and, in fact, a material portion of our existing research and development expenses are utilized toward the development of such new technologies discussed above. While we are confident in our ability to meet these changing industry demands with our Simpana suite and potential future

releases, the development, release and timing of any features or functionality remain at our sole discretion and our solutions or other technologies may not be widely adopted.

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The rapid growth of data, and the need to securely protect, manage and access this data is driving substantial opportunities for managed service providers to help organizations deploy and manage solutions that deliver data management capabilities. The result is reduced long-term management costs with increased offerings to customers, which we believe represents a long-term industry trend in the way that services are offered.

Given the nature of the industry in which we operate, our software applications are subject to obsolescence. As noted above, we continually develop and introduce updates to our existing software applications in order to keep pace with evolving industry technologies. In addition, we must address evolving industry standards, changing customer requirements and competitive software applications that may render our existing software applications obsolete. For each of our software applications, we provide full support for the current generally available release and one prior release. When we declare a product release obsolete, a customer notice is delivered twelve months prior to the effective date of obsolescence announcing continuation of full product support for the first six months. We provide an additional six months of extended assistance support in which we only provide existing workarounds or fixes that do not require additional development activity. We do not have existing plans to make any of our software products permanently obsolete.

Sources of Revenues

We derive a significant portion of our total revenues from sales of licenses of our software applications. We do not customize our software for a specific end-user customer. We sell our software applications to end-user customers both directly through our sales force and indirectly through our global network of value-added reseller partners, systems integrators, corporate resellers and original equipment manufacturers. Our software revenue was 47% and 49% of our total revenues for the six months ended September 30, 2014 and 2013, respectively.

In recent fiscal years, we have generated approximately two-thirds of our software revenue from our existing customer base and approximately one-third of our software revenue from new customers. In addition, our total software revenue in any particular period is, to a certain extent, dependent upon our ability to generate revenues from large customer software deals, which we refer to as enterprise software transactions. We expect the number of enterprise software transactions (transactions greater than \$0.1 million) and resulting software revenue to increase throughout fiscal 2015, although the size and timing of any particular software transaction is more difficult to forecast. Such software transactions represented approximately 59% and 56% of our total software revenue in the six months ended September 30, 2014 and 2013, respectively.

Software revenue generated through indirect distribution channels was approximately 82% of total software revenue in the six months ended September 30, 2014 and was approximately 91% of total software revenue in the six months ended September 30, 2013. Software revenue generated through direct distribution channels was approximately 18% of total software revenue in the six months ended September 30, 2014 and was approximately 9% of total software revenue in the six months ended September 30, 2013. The dollar value of software revenue generated through indirect distribution channels decreased approximately \$8.4 million, or 7%, in the six months ended September 30, 2014 compared to the six months ended September 30, 2013. The dollar value of software revenue generated through direct distribution channels increased approximately \$13.7 million, or 114%, in the six months ended September 30, 2014 compared to the six months ended September 30, 2013. The increase in the dollar value of software revenue growth generated through our direct sales force compared to our indirect distribution channels in the six months ended September 30, 2014 is primarily the result of an increase in software revenue from several large enterprise transactions in the U.S. which were conducted through our direct sales force. Deals initiated by our direct sales force are sometimes transacted through indirect channels based on end-user customer requirements, which are not always in our control and can cause this overall percentage split to vary from period to period. As such, there may be fluctuations in the dollars and percentage of software revenue generated through our direct distribution channels from time to time. We believe that the growth of our software revenue, derived from both our indirect channel partners and direct sales force, are key attributes to our long-term growth strategy. We will continue to invest in both our channel relationships and direct sales force in the future, but we continue to expect more revenue to be generated through indirect distribution channels over the long term. The failure of our indirect distribution channels or our direct sales force to effectively sell our software applications could have a material adverse effect on our revenues and results of operations.

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We have a global original equipment manufacturer agreement with NetApp under which NetApp will integrate elements of our Simpana software suite with NetApp SnapShot™ and replication technology, under the NetApp SnapProtect® brand. We also have an original equipment manufacturer agreement with Hitachi Data Systems for them to market, sell and support our software applications and services on a stand-alone basis and/or incorporate our software applications into their own hardware products. As a result, Hitachi Data Systems can also sell our software in a reseller capacity under the terms of our original equipment manufacturer agreement with them. Hitachi Data Systems and NetApp have no obligation to recommend or offer our software applications exclusively or at all, and they have no minimum sales requirements and can terminate our relationship at any time. Sales through our original equipment manufacturer agreements, accounted for 16% of our total revenues for the six months ended September 30, 2014 and 13% of our total revenues for the six months ended September 30, 2013.

We also have non-exclusive distribution agreements covering our North American commercial markets and our U.S. Federal Government market with Arrow Enterprise Computing Solutions, Inc. ("Arrow"), a subsidiary of Arrow Electronics, Inc., and Avnet Technology Solutions ("Avnet"), a subsidiary of Avent, Inc. Pursuant to these distribution agreements, these distributors' primary role is to enable a more efficient and effective distribution channel for our products and services by managing our reseller partners and leveraging their own industry experience. We generated approximately 34% of our total revenues through Arrow in the six months ended September 30, 2014 and approximately 31% in the six months ended September 30, 2013. If Arrow or Avnet were to discontinue or reduce the sales of our products or if our agreement with Arrow or Avnet was terminated, and if we were unable to take back the management of our reseller channel or find another North American distributor to replace Arrow or Avnet, then it could have a material adverse effect on our future business.

We derive approximately half of our total revenues from services revenue. Our services revenue is made up of fees from the delivery of customer support and other professional services, which are typically sold in connection with the sale of our software applications. Customer support agreements provide technical support and unspecified software updates on a when-and-if-available basis for an annual fee based on licenses purchased and the level of service subscribed. Other professional services include consulting, assessment and design services, implementation and post-deployment services and training, all of which to date have predominantly been sold in connection with the sale of software applications. Our services revenue was 53% of our total revenues for the six months ended September 30, 2014 and 51% of our total revenues for the six months ended September 30, 2013.

The gross margin of our services revenue was 75.4% for the six months ended September 30, 2014 and 75.3% for the six months ended September 30, 2013. Overall, our services revenue has lower gross margins than our software revenue. The gross margin of our software revenue was 99.1% for both the six months ended September 30, 2014 and for the six months ended September 30, 2013. An increase in the percentage of total revenues represented by services revenue may adversely affect our overall gross margins.

Description of Costs and Expenses

Our cost of revenues is as follows:

- Cost of Software Revenue, consists primarily of third-party royalties and other costs such as media, manuals, translation and distribution costs; and

- Cost of Services Revenue, consists primarily of salary and employee benefit costs in providing customer support and other professional services.

Our operating expenses are as follows:

- Sales and Marketing, consists primarily of salaries, commissions, employee benefits, stock-based compensation and other direct and indirect business expenses, including travel and related expenses, sales promotion expenses, public relations expenses and costs for marketing materials and other marketing events (such as trade shows and advertising);

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Research and Development, which is primarily the expense of developing new software applications and modifying existing software applications, consists principally of salaries, stock-based compensation and benefits for research and development personnel and related expenses; contract labor expense and consulting fees as well as other expenses associated with the design, certification and testing of our software applications; and legal costs associated with the patent registration of such software applications;

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General and Administrative, consists primarily of salaries, stock-based compensation and benefits for our executive, accounting, human resources, legal, information systems and other administrative personnel. Also included in this category are other general corporate expenses, such as outside legal and accounting services, compliance costs and insurance; and

Depreciation and Amortization, consists of depreciation expense primarily for computer equipment we use for information services and in our development and test labs.

We anticipate that each of the above categories of operating expenses will increase in dollar amounts, but will decline as a percentage of total revenues in the long-term.

Foreign Currency Exchange Rates' Impact on Results of Operations

Sales outside the United States were approximately 42% of our total revenue for the six months ended September 30, 2014 and 40% for the six months ended September 30, 2013. The income statements of our non-U.S. operations are translated into U.S. dollars at the average exchange rates for each applicable month in a period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency denominated transactions generally results in increased revenue, operating expenses and income from operations for our non-U.S. operations. Similarly, our revenue, operating expenses and net income will generally decrease for our non-U.S. operations if the U.S. dollar strengthens against foreign currencies.

Using the average foreign currency exchange rates from the three months ended September 30, 2013 our total revenues would have been lower by \$0.1 million, our cost of sales would have been lower by approximately \$0.1 million and our operating expenses would have been lower by \$0.6 million from non-U.S. operations for the three months ended September 30, 2014. Using the average foreign currency exchange rates from the six months ended September 30, 2014, our total revenues would have been lower by \$1.4 million, our cost of sales would have been lower by \$0.4 million and our operating expenses would have been lower by \$2.1 million from non-U.S. operations. In addition, we are exposed to risks of foreign currency fluctuation primarily from cash balances, accounts receivables and intercompany accounts denominated in foreign currencies and are subject to the resulting transaction gains and losses, which are recorded as a component of general and administrative expenses. We recognized net foreign currency transaction losses of approximately \$0.1 million and \$0.2 million in the three and six months ended September 30, 2014, respectively, and net foreign currency transaction gains of approximately \$0.2 million and \$0.4 million in the three and six months ended September 30, 2013, respectively.

Critical Accounting Policies

In presenting our consolidated financial statements in conformity with U.S. generally accepted accounting principles, we are required to make estimates and judgments that affect the amounts reported therein. Some of the estimates and assumptions we are required to make relate to matters that are inherently uncertain as they pertain to future events. We base these estimates on historical experience and on various other assumptions that we believe to be reasonable and appropriate. Actual results may differ significantly from these estimates. The following is a description of our accounting policies that we believe require subjective and complex judgments, which could potentially have a material effect on our reported financial condition or results of operations.

Revenue Recognition

Our revenue recognition policy is based on complex rules that require us to make significant judgments and estimates. In applying our revenue recognition policy, we must determine which portions of our revenue are recognized currently (generally software revenue) and which portions must be deferred and recognized in future periods (generally services revenue). We analyze various factors including, but not limited to, the sales of undelivered services when sold on a stand-alone basis, our pricing policies, the credit-worthiness of our customers and resellers, accounts receivable aging data and contractual terms and conditions in helping us to make such judgments about revenue recognition. Changes in judgment on any of these factors could materially impact the timing and amount of revenue recognized in a given period.

Currently, we derive revenues from two primary sources: software licenses and services. Services include customer support, consulting, assessment and design services, installation services and training. A typical sales arrangement

includes both of these services.

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For sales arrangements involving multiple elements, we recognize revenue using the residual method. Under the residual method, we allocate and defer revenue for the undelivered elements based on fair value and recognize the difference between the total arrangement fee and the amount deferred for the undelivered elements as revenue. The determination of fair value of the undelivered elements in multiple-element arrangements is based on the price charged when such elements are sold separately, which is commonly referred to as vendor-specific objective evidence (“VSOE”).

Our software licenses typically provide for a perpetual right to use our software and are sold on a per-copy basis, on a capacity basis or as site licenses. Software licenses sold on a capacity basis provide the customer with unlimited licenses of specified software products based on a defined level of terabytes of data under management. Site licenses give the customer the additional right to deploy the software on a limited basis during a specified term. We recognize software revenue through direct sales channels upon receipt of a purchase order or other persuasive evidence and when the other three basic revenue recognition criteria are met as described in the revenue recognition section in Note 2 of our “Notes to Consolidated Financial Statements.” We recognize software revenue through all indirect sales channels on a sell-through model. A sell-through model requires that we recognize revenue when the basic revenue recognition criteria are met and these channels complete the sale of our software products to the end-user. Revenue from software licenses sold through an original equipment manufacturer partner is recognized upon the receipt of a royalty report or purchase order from that original equipment manufacturer partner.

Services revenue includes revenue from customer support and other professional services. Customer support includes software updates on a when-and-if-available basis, telephone support, integrated web-based support and bug fixes or patches. Customer support revenue is recognized ratably over the term of the customer support agreement, which is typically one year. To determine the price for the customer support element when sold separately, we primarily use historical renewal rates. Historical renewal rates are supported by a rolling 12-month VSOE analysis in which we segregate our customer support renewal contracts into different classes based on specific criteria including, but not limited to, dollar amount of software purchased, level of customer support being provided and distribution channel. The purpose of such an analysis is to determine if the customer support element that is deferred at the time of a software sale is consistent with how it is sold on a stand-alone renewal basis.

Our other professional services include consulting; implementation and post deployment services; and education services. Other professional services provided by us are not mandatory and can also be performed by the customer or a third-party. In addition to a signed purchase order, our consulting, assessment and design services and installation services are, in some cases, evidenced by a Statement of Work, which defines the specific scope of the services to be performed when sold and performed on a stand-alone basis or included in multiple-element sales arrangements.

Revenues from consulting, assessment and design services and installation services are based upon a daily, weekly or monthly rate and are recognized when the services are completed. Training includes courses taught by our instructors or third-party contractors either at one of our facilities or at the customer’s site. Training fees are recognized as revenue after the training course has been provided. Based on our analysis of such other professional services transactions sold on a stand-alone basis, we have concluded we have established VSOE for such other professional services when sold in connection with a multiple-element sales arrangement.

In summary, we have analyzed all of the undelivered elements included in our multiple-element sales arrangements and determined that we have VSOE of fair value to allocate revenues to services. Our analysis of the undelivered elements has provided us with results that are consistent with the estimates and assumptions used to determine the timing and amount of revenue recognized in our multiple-element sales arrangements. Accordingly, assuming all basic revenue recognition criteria are met, software revenue is recognized upon delivery of the software license using the residual method. We are not likely to materially change our pricing and discounting practices in the future.

Our sales arrangements generally do not include acceptance clauses. However, if an arrangement does include an acceptance clause, we defer the revenue for such an arrangement and recognize it upon acceptance. Acceptance occurs upon the earliest of receipt of a written customer acceptance, waiver of customer acceptance or expiration of the acceptance period.

Stock-Based Compensation

As of September 30, 2014, we maintain two stock incentive plans. We account for our stock incentive plans based on the grant date fair value recognition provisions in accordance with ASC 718. We estimated the fair value of stock options granted using the Black-Scholes formula. The fair value of restricted stock units awarded is determined based on the number of shares granted and the closing price of our common stock on the date of grant. Compensation for all share-based payment awards is recognized on a straight-line basis over the requisite service period of the awards, which is generally the vesting period. Forfeitures are estimated based on a historical analysis of our actual stock award forfeitures. We anticipate that future grants under our stock incentive plans will include both non-qualified stock options and restricted stock units.

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For the three and six months ended September 30, 2014, our calculation of expected term includes a combination of actual exercise data and an assumption on when the remaining outstanding options with similar characteristics will be exercised based on our historical data. In determining expected life, we separate employees into groups that have historically exhibited similar behavior with regard to option exercises.

Expected volatility for the three and six months ended September 30, 2014 was calculated based on the implied volatility of our traded options with a maturity greater than six months and the historical realized volatility of our common stock.

For the three and six months ended September 30, 2014, the risk-free interest rate is determined by reference to U.S. Treasury yield curve rates with a remaining term that is approximately the expected life assumed at the date of grant. Forfeitures are estimated based on our historical analysis of actual stock option forfeitures.

The assumptions used in the Black-Scholes option-pricing model in the three and six months ended September 30, 2014 and 2013 are as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Dividend yield	None	None	None	None
Expected volatility	43-47%	44-45%	43-47%	44%-47%
Weighted average expected volatility	46%	44%	46%	45%
Risk-free interest rates	1.58%-2.18%	1.43%-1.65%	1.57-2.18%	0.70%-1.65%
Weighted average expected life (in years)	5.5	4.6	5.2	4.6

The weighted average fair value of stock options granted was \$21.85 per option and \$21.22 per option during the three and six months ended September 30, 2014, respectively, and \$32.48 per option and \$29.32 during the three and six months ended September 30, 2013, respectively. In addition, the weighted average fair value of restricted stock units awarded was \$51.24 per unit and \$51.56 per unit during the three and six months ended September 30, 2014, respectively, and \$84.85 per unit and \$78.42 per unit during the three and six months ended September 30, 2013, respectively.

As of September 30, 2014, there was approximately \$108.9 million of unrecognized stock-based compensation expense, net of estimated forfeitures, related to non-vested stock option and restricted stock unit awards that is expected to be recognized over a weighted average period of 2.32 years. To the extent the actual forfeiture rate is different from what we have estimated, stock-based compensation related to these awards will be different from the current estimate.

Accounting for Income Taxes

As part of the process of preparing our financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure, including assessing the risks associated with tax audits, and assessing temporary differences resulting from different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. As of September 30, 2014, we had net deferred tax assets of approximately \$47.1 million, which were primarily related to federal and state research tax credit carryforwards, stock-based compensation and foreign net operating loss carryforwards. We assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent that we believe recovery is not likely, we establish a valuation allowance.

As of September 30, 2014, we had unrecognized tax benefits of \$2.8 million, all of which, if recognized, would favorably affect the effective tax rate. In addition, we have accrued interest and penalties of \$0.3 million related to the unrecognized tax benefits. Interest and penalties, if any, related to unrecognized tax benefits are recorded in income tax expense. Components of the reserve are classified as either current or long-term in the Consolidated Balance Sheet based on when we expect each of the items to be settled. Accordingly, our unrecognized tax benefits of \$2.8 million and the related accrued interest and penalties of \$0.3 million are included in Other Liabilities on the Consolidated Balance Sheet.

The Company conducts business globally and as a result, files income tax returns in the United States and in various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing

authorities throughout the world, including such major jurisdictions as the United States, Australia, Canada, Germany, Netherlands and United Kingdom. The Company's Federal income tax returns for fiscal 2012 and 2013 are currently under audit. Additionally, the Company's New Jersey tax returns for fiscal 2010 through 2013 are currently under audit.

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Software Development Costs

Research and development expenditures are charged to operations as incurred. Based on our software development process, technological feasibility is established upon completion of a working model, which also requires certification and extensive testing. Costs incurred by us between completion of the working model and the point at which the product is ready for general release are immaterial.

Results of Operations

The following table sets forth each of our sources of revenues and costs of revenues for the specified periods as a percentage of our total revenues for those periods (due to rounding, numbers in column may not sum to totals):

	Three Months Ended September 30,		Six Months Ended September 30,		
	2014	2013	2014	2013	
Revenues:					
Software	46	% 50	% 47	% 49	%
Services	54	% 50	% 53	% 51	%
Total revenues	100	% 100	% 100	% 100	%
Cost of revenues:					
Software	—	% —	% —	% —	%
Services	13	% 12	% 13	% 13	%
Total cost of revenues	13	% 13	% 14	% 13	%
Gross margin	87	% 87	% 86	% 87	%

Three months ended September 30, 2014 compared to three months ended September 30, 2013

Revenues

Total revenues increased \$9.3 million, or 7%, from \$141.9 million in the three months ended September 30, 2013 to \$151.1 million in the three months ended September 30, 2014.

Software Revenue. Software revenue decreased \$1.4 million, or 2%, from \$70.8 million in the three months ended September 30, 2013 to \$69.4 million in the three months ended September 30, 2014. Software revenue represented 46% of our total revenues in the three months ended September 30, 2014 and compared to 50% of total revenues in the three months ended September 30, 2013.

The decrease in software revenue is primarily due to lower software revenue derived from our domestic operations, which decreased 4% in the three months ended September 30, 2014 compared to the three months ended September 30, 2013. This decrease was partially offset by our international operations, which increased 1% in the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

Software revenue derived from enterprise software transactions (transactions greater than \$0.1 million) represented approximately 56% of our software revenue in the three months ended September 30, 2014 and approximately 57% of our software revenue in the three months ended September 30, 2013. As a result, enterprise software transactions decreased by \$2.0 million, or 5%, in the three months ended September 30, 2014 compared to the three months ended September 30, 2013. This decrease was primarily driven by a 5% decrease in the average dollar amount of such transactions. The average dollar amount of such transactions was approximately \$281,000 in the three months ended September 30, 2014 and approximately \$295,000 in the three months ended September 30, 2013. Software revenue derived from transactions less than \$0.1 million increased \$0.6 million, or 2%, in the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

Software revenue derived from our indirect distribution channel (resellers and original equipment manufacturers) decreased \$5.0 million, or 8%, in the three months ended September 30, 2014 compared to the three months ended September 30, 2013, and software revenue through our direct sales force increased \$3.6 million, or 73%, in the three months ended September 30, 2014 compared to the three months ended September 30, 2013. For additional discussion on software revenue derived from our direct sales force see the Sources of Revenue section.

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Services Revenue. Services revenue increased \$10.7 million, or 15%, from \$71.0 million in the three months ended September 30, 2013 to \$81.7 million in the three months ended September 30, 2014. Services revenue represented 54% of our total revenues in the three months ended September 30, 2014 and 50% in the three months ended September 30, 2013. The increase in services revenue is primarily due to a \$10.5 million increase in revenue from customer support agreements as a result of software sales to new customers and renewal agreements with our installed software base.

Cost of Revenues. Total cost of revenues increased \$2.1 million, or 12%, from \$18.2 million in the three months ended September 30, 2013 to \$20.3 million in the three months ended September 30, 2014. Total cost of revenues represented 13% of our total revenues in three months ended September 30, 2014 and September 30, 2013.

Cost of Software Revenue. Cost of software revenue was \$0.7 million and \$0.6 million in the three months ended September 30, 2014 and 2013, respectively.

Cost of Services Revenue. Cost of services revenue increased \$2.1 million, or 12%, from \$17.5 million in the three months ended September 30, 2013 to \$19.6 million in the three months ended September 30, 2014. Cost of services revenue represented 24% of our services revenue in the three months ended September 30, 2014 and 25% in the and three months ended September 30, 2013.

Operating Expenses

Sales and Marketing. Sales and marketing expenses increased \$16.6 million, or 25%, from \$67.1 million in the three months ended September 30, 2013 to \$83.7 million in the three months ended September 30, 2014. The increase is primarily due to a \$9.0 million increase in employee compensation and related expenses mainly attributable to the expansion of our sales force from the prior year. The increase in sales and marketing expenses also includes a \$2.5 million increase in stock-based compensation expenses and \$1.4 million of increases in marketing related activities.

Sales and marketing expenses as a percentage of total revenues increased to 55% in the three months ended September 30, 2014 from 47% in the three months ended September 30, 2013.

Research and Development. Research and development expenses increased \$2.5 million, or 19%, from \$13.3 million in the three months ended September 30, 2013 to \$15.8 million in the three months ended September 30, 2014. The increase is primarily due to a \$1.8 million increase in salary and related expenses resulting from the expansion of our engineering group and a \$0.5 million increase in stock-based compensation expenses. Research and development expenses as a percentage of total revenues was 10% in the three months ended September 30, 2014 and 9% in the three months ended September 30, 2013. Investing in research and development has been a priority for CommVault, and we anticipate continued spending related to the development of our data and information management software applications.

General and Administrative. General and administrative expenses increased \$3.4 million, or 23%, from \$15.3 million in the three months ended September 30, 2013 to \$18.7 million in the three months ended September 30, 2014. This increase is primarily due to a \$1.5 million increase in employee compensation and related expenses. The increase in general and administrative expenses also includes a \$0.9 million increase in stock-based compensation expenses.

General and administrative expenses in the three months ended September 30, 2014 includes approximately \$0.1 million of net foreign currency transaction losses compared to approximately \$0.2 million of net foreign currency transaction gains recognized in general and administrative expenses in the three months ended September 30, 2013.

General and administrative expenses as a percentage of total revenues was 12% in the three months ended September 30, 2014 and 11% in the three months ended September 30, 2013.

Depreciation and Amortization. Depreciation expense increased by \$0.2 million from \$1.5 million in the three months ended September 30, 2013 to \$1.7 million in the three months ended September 30, 2014. We expect depreciation expense to increase in the second half of the current fiscal year due to our new corporate campus headquarters which is currently under construction.

Income Tax Expense

Income tax expense was \$4.4 million in the three months ended September 30, 2014 compared to \$9.3 million in the three months ended September 30, 2013. The effective tax rate in the three months ended September 30, 2014 was 40% as compared to 35% in the three months ended September 30, 2013. The effective rate in the three months ended September 30, 2014 is higher than the federal statutory rate due to state income taxes and permanent differences in

both the United States and foreign jurisdictions. These items were partially offset by foreign tax credits and domestic production activities deductions. The effective rate in the three months ended September 30, 2013 approximates the federal statutory rate but is impacted by state income taxes and permanent differences in both the United States and foreign jurisdictions partially offset by income tax benefits from research and development tax credits, foreign tax credits, and domestic production activities deductions.

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Six months ended September 30, 2014 compared to six months ended September 30, 2013

Revenues

Total revenues increased \$27.5 million, or