PROOFPOINT INC
Form 10-Q
May 07, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ	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

o	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 001-35506
PROOFPOINT, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	51-0414846 (I.R.S. employer identification no.)
892 Ross Drive Sunnyvale, California (Address of principal executive offices)	94089 (Zip Code)

(408) 517-4710

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 þ NO o

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 þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ Shares of Proofpoint, Inc. common stock, $0.0001 par value per share, outstanding as of April 24, 2015:

39,421,209 shares.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.
Proofpoint, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except per share amounts)
(Unaudited)

	March 31, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$170,005	$180,337
Short-term investments	23,530	34,649
Accounts receivable, net of allowance for doubtful accounts of $155 and $429 as of March 31, 2015 and December 31, 2014, respectively	32,146	40,912
Inventory	426	499
Deferred product costs	1,390	1,847
Prepaid expenses and other current assets	8,178	7,994
Total current assets	235,675	266,238
Property and equipment, net	21,796	18,718
Deferred product costs	561	307
Goodwill	126,875	107,504
Intangible assets, net	36,879	27,086
Other assets	4,174	4,397
Total assets	$425,960	$424,250
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$10,470	$9,249
Accrued liabilities	23,648	24,220
Equipment loans and capital lease obligations	280	695
Deferred rent	544	569
Deferred revenue	124,147	123,550
Total current liabilities	159,089	158,283
Convertible senior notes	163,882	161,630
Long-term deferred rent	2,038	2,099
Other long-term liabilities	5,227	6,640
Long-term deferred revenue	47,819	39,125
Total liabilities	378,055	367,777
Commitments and contingencies (Note 5)		
Stockholders’ equity:		
Convertible preferred stock, $0.0001 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value; 200,000 shares authorized; 39,336 and 38,665 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively	4	4
Additional paid-in capital	343,829	330,744
Accumulated other comprehensive loss	(7)	(27)

Accumulated deficit	(295,921)	(274,248)
Total stockholders' equity	47,905	56,473
Total liabilities and stockholders' equity	$425,960	$424,250

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31, 2015	2014
Revenue:		
Subscription	$55,856	$41,204
Hardware and services	1,907	1,500
Total revenue	57,763	42,704
Cost of revenue:(1)(2)		
Subscription	16,334	11,451
Hardware and services	2,954	2,260
Total cost of revenue	19,288	13,711
Gross profit	38,475	28,993
Operating expense:(1)(2)		
Research and development	15,708	11,948
Sales and marketing	32,912	22,818
General and administrative	7,333	5,506
Total operating expense	55,953	40,272
Operating loss	(17,478)	(11,279)
Interest expense, net	(2,853)	(2,773)
Other expense, net	(1,180)	(199)
Loss before provision for income taxes	(21,511)	(14,251)
Provision for income taxes	(162)	(144)
Net loss	$(21,673)	$(14,395)
Net loss per share, basic and diluted	$(0.56)	$(0.39)
Weighted average shares outstanding, basic and diluted	38,957	36,564
(1) Includes stock based compensation expense as follows:		
Cost of subscription revenue	$1,115	$412
Cost of hardware and services revenue	254	129
Research and development	3,938	2,034
Sales and marketing	4,869	2,097
General and administrative	2,250	1,301
(2) Includes intangible amortization expense as follows:		
Cost of subscription revenue	$1,380	$829
Research and development	23	23
Sales and marketing	1,293	1,097
General and administrative	11	11

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(In thousands)
(Unaudited)

	Three Months Ended March 31, 2015	2014
Net loss	$(21,673)	$(14,395)
Other comprehensive loss, net of tax:		
Unrealized gains on short-term investments, net	20	—
Comprehensive loss	$(21,653)	$(14,395)

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three Months Ended March 31, 2015	2014
Cash flows from operating activities		
Net loss	$(21,673)	$(14,395)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	5,464	3,802
Loss on disposal of property and equipment	3	—
Amortization of investment premiums, net of accretion of purchase discounts	128	15
Provision for allowance for doubtful accounts	(274)	(7)
Stock based compensation	12,426	5,973
Deferred income taxes	281	117
Change in fair value of contingent earn-outs	—	5
Amortization of debt issuance costs and accretion of debt discount	2,266	2,143
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	9,810	3,881
Inventory	73	(435)
Deferred products costs	203	(143)
Prepaid expenses	(799)	(526)
Other current assets	647	(263)
Long-term assets	15	(89)
Accounts payable	247	762
Accrued liabilities	(5,410)	(613)
Deferred rent	(111)	(18)
Deferred revenue	8,591	3,910
Net cash provided by operating activities	11,887	4,119
Cash flows from investing activities		
Proceeds from sales and maturities of short-term investments	11,012	8,000
Purchase of property and equipment	(4,584)	(2,291)
Acquisitions of businesses, net of cash acquired	(28,114)	—
Net cash (used in) provided by investing activities	(21,686)	5,709
Cash flows from financing activities		
Proceeds from issuance of common stock	4,019	4,731
Withholding taxes related to restricted stock net share settlement	(4,137)	(576)
Payments of debt issuance costs	—	(111)
Repayments of notes payable and loans	(415)	(411)
Net cash (used in) provided by financing activities	(533)	3,633
Net (decrease) increase in cash and cash equivalents	(10,332)	13,461
Cash and cash equivalents		
Beginning of period	180,337	243,786
End of period	$170,005	$257,247
Supplemental disclosure of noncash investing and financing information		
Unpaid purchases of property and equipment	$3,656	$2,219

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)
(Dollars and share amounts in thousands, except per share amounts)
1. The Company and Summary of Significant Accounting Policies
The Company
Proofpoint, Inc. (the “Company”) was incorporated in Delaware in June 2002 and is headquartered in California. Proofpoint is a leading security-as-a-service provider that enables large and mid-sized organizations worldwide to defend, protect, archive and govern their most sensitive data. The Company's security-as-a-service platform is comprised of a number of data protection solutions, including threat protection and incident response, regulatory compliance, archiving, governance and eDiscovery, and secure communication.

Basis of Presentation and Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

The Company acquired one company in the three months ended March 31, 2015 and two companies in the year ended December 31, 2014, these acquisitions are more fully described in Note 2, "Acquisitions". The consolidated financial statements include the results of operations from these business combinations from their date of acquisition.

The accompanying condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”), pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and note disclosures have been condensed or omitted pursuant to such rules and regulations. The accompanying Condensed Consolidated Balance Sheet as of December 31, 2014 is derived from audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair statement of the periods presented. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015 or for other interim periods or for future years.

These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and accompanying notes for the year ended December 31, 2014 included in the Company’s Annual Report on Form 10-K filed with the SEC. The Company’s significant accounting policies are described in Note 1 to those audited consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates and such difference may be material to the financial statements.

Goodwill and Intangible Assets
Goodwill represents the excess of the purchase price of the acquired enterprise over the fair value of identifiable assets acquired and liabilities assumed. The Company performs an annual goodwill impairment test during the fourth quarter

of a calendar year and more frequently if an event or circumstances indicates that impairment may have occurred. For the purposes of impairment testing, the Company has determined that it has one operating segment and one reporting unit. The Company

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performs a two-step impairment test of goodwill whereby the fair value of the reporting unit is compared to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not considered impaired and further testing is not required. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then impairment loss equal to the difference is recorded. The identification and measurement of goodwill impairment involves the estimation of the fair value of the Company. The estimate of fair value of the Company, based on the best information available as of the date of the assessment, is subjective and requires judgment, including management assumptions about expected future revenue forecasts and discount rates, changes in the overall economy, trends in the stock price and other factors. No impairment indicators were identified by the Company as of March 31, 2015.

Intangible assets consist of developed technology, customer relationships, non-compete arrangements, trademarks and patents, order backlog and in-process research and development asset. The values assigned to intangibles are based on estimates and judgments regarding expectations for success and life cycle of solutions and technologies acquired.

Intangible assets are amortized on a straight-line basis over their estimated lives, which approximate the pattern in which the economic benefits of the intangible assets are consumed, as follows (in years):

	Low	High
Patents	4	5
Developed technology	3	7
Customer relationships	2	7
Non-compete agreements	2	4
Order backlog	1	2
Trade names and trademarks	1	5

In-process research and development asset is not amortized until the associated project is completed.

Revenue Recognition

The Company derives its revenue primarily from two sources: (1) subscription revenue for rights related to the use of the security-as-a-service platform and (2) hardware, training and professional services revenue provided to customers related to their use of the platform. The Company records its revenues net of any value added or sales tax. Subscription revenue is derived from a subscription based enterprise licensing model with contract terms typically ranging from one to three years, and consists of (i) subscription fees from the licensing of the security-as-a-service platform, (ii) subscription fees for access to the on-demand elements of the platform and (iii) subscription fees for the right to access the Company's customer support services.

Revenue is recognized when all of the following criteria have been met:

- Persuasive evidence of an arrangement exists;

- Delivery has occurred or services have been rendered;

- Sales price is fixed or determinable; and

- Collectability is reasonably assured

The Company's revenue arrangements typically include subscription services to its security-as-a-service platform. These hosted on demand service arrangements do not provide customers with the right to take possession of the software supporting the hosted services. Certain arrangements also include the sale of hardware appliances. Revenue from hardware appliances containing software components and hardware components that function together to deliver the hardware appliance's essential functionality is excluded from the scope of the industry specific revenue recognition guidance. The Company recognizes revenue from its hosted on demand services in accordance with general revenue recognition accounting guidance. Only revenue derived from the licensing of the software is recognized in accordance with the industry specific revenue guidance.

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The Company applies industry-specific software revenue recognition guidance to transactions involving the licensing of software, as well as related support, training, and other professional services. The Company has analyzed all of the elements included in its multiple element software arrangements and has determined that it does not have sufficient VSOE of fair value to allocate revenue to its subscription and software license agreements, support, training, and professional services. The Company defers all revenue under the software arrangement until the commencement of the subscription services and any associated professional services. Once the subscription services and the associated professional services have commenced, the entire fee from the arrangement is recognized ratably over the remaining period of the arrangement. If the professional services are essential to the functionality of the subscription, then the revenue recognition does not commence until such services are completed.

When a sales arrangement contains multiple elements, such as hardware appliances, subscription services, customer support services, and/or professional services, the Company allocates revenue to each unit of accounting or element based on a selling price hierarchy. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company's control. When applying the relative selling price method, the Company determines the selling price for each deliverable using vendor-specific objective evidence (“VSOE”) of selling price. If VSOE does not exist, the Company uses third-party evidence (“TPE”) of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, the Company uses its best estimate of selling price ("BESP") for that deliverable. Revenue allocated to each element is then recognized when the basic revenue recognition criteria are met for each element. The Company determines BESP for an individual element within a multiple element revenue arrangement using the same methods utilized to determine the selling price of an element sold on a standalone basis. The Company estimates the selling price for its subscription solutions by considering internal factors such as historical pricing practices and it estimates the selling price of hardware and other services using a cost plus model.

Hardware appliance revenue is recognized upon shipment. Subscription and support revenue are recognized over the contract period commencing on the start date of the contract. Professional services and training, when sold with hardware appliances or subscription and support services, are accounted for separately when those services have standalone value. In determining whether professional services and training services can be accounted for separately from subscription and support services, the Company considers the following factors: availability of the services from other vendors, the nature of the services, and the dependence of the subscription services on the customer’s decision to buy the professional services. If professional services and training do not qualify for separate accounting, the Company recognizes the professional services and training ratably over the contract term of the subscription services.

Delivery generally occurs when the hardware appliance is delivered to a common carrier freight on board shipping point by the Company or the hosted service has been activated and communicated to the customer accordingly. The Company’s fees are typically considered to be fixed or determinable at the inception of an arrangement and are negotiated at the outset of an arrangement, generally based on specific products and quantities to be delivered. In the event payment terms are provided that differ significantly from the Company's standard business practices, the fees are deemed to not be fixed or determinable and revenue is recognized as the fees become paid.

The Company assesses collectability based on a number of factors, including credit worthiness of the customer and past transaction history of the customer. Through March 31, 2015, the Company has not experienced significant credit losses.

Deferred Revenue

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from the sale of the Company’s subscription fees, training and professional services. Once the revenue recognition criteria are met, this revenue is recognized ratably over the term of the associated contract.

Comprehensive Loss

Comprehensive loss includes all changes in equity that are not the result of transactions with stockholders. The Company’s comprehensive loss consists of its net loss and changes in unrealized gains (losses) from its available-for-sale investments. The Company had no significant reclassifications out of accumulated other comprehensive loss into net loss for the three months ended March 31, 2015 and 2014.

Recent Accounting Policies

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In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2015-03, Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03), which requires the Company to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. ASU 2015-03 will be effective for annual reporting periods beginning after December 15, 2015 and interim periods within fiscal years beginning after December 15, 2016, with early adoption permitted. The new guidance will be applied retrospectively to each prior period presented. The Company is currently in the process of evaluating the impact and timing of adoption of the ASU 2015-03 on its consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for the Company starting January 1, 2017 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. The Company is currently evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

2. Acquisitions

Acquisitions are accounted for under the purchase method of accounting in which the tangible and identifiable intangible assets and liabilities of each acquired company are recorded at their respective fair values as of each acquisition date, including an amount for goodwill representing the difference between the respective acquisition consideration and fair values of identifiable net assets. The Company believes that for each acquisition, the combined entities will achieve savings in corporate overhead costs and opportunities for growth through expanded geographic and customer segment diversity with the ability to leverage additional products and capabilities. These factors, among others, contributed to a purchase price in excess of the estimated fair value of each acquired company's net identifiable assets acquired and, as a result, goodwill was recorded in connection with each acquisition. Goodwill related to each acquisition below, other than Emerging Threats Pro, LLC, is not deductible for tax purposes.

While the Company uses its best estimates and assumptions as part of the purchase price allocation process to value assets acquired and liabilities assumed at the acquisition date, these estimates and assumptions are subject to refinement. When additional information becomes available, such as finalization of negotiations of working capital adjustments and tax related matters, the Company may revise its preliminary purchase price allocation. As a result, during the preliminary purchase price allocation period, which may be up to one year from the acquisition date, the Company may record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Subsequent to the purchase price allocation period, adjustments to assets acquired or liabilities assumed are recognized in the operating results.

During the three months period ended March 31, 2015 and for the year ended December 31, 2014, the Company acquired a total of 3 companies (collectively, the "Acquisitions") which are further described below.

Emerging Threats Pro, LLC

On March 6, 2015 (the "Emerging Threats Acquisition Date"), pursuant to the terms of a Purchase Agreement, the Company acquired 100% of membership interests in Emerging Threats Pro, LLC ("Emerging Threats"). Based in Indianapolis, Indiana, Emerging Threats provides threat intelligence solutions to help protect networks from known or potentially malicious threats. With this acquisition, the Company intends to integrate Emerging Threat's advanced threat intelligence solutions with its existing Targeted Attack Protection and Threat Response security solutions to advance threat detection and response across the completed attack chain. The combined technology will provide customers with deeper insight into cyberthreats, enabling them to react faster to inbound cyberattacks, and to identify, block, and disable previously undetected malware already embedded in their organizations.

The Company has provisionally estimated the fair values for the acquired tangible and identifiable intangible assets and liabilities assumed at the Emerging Threats Acquisition Date. The amounts reported were considered provisional as the Company was completing the valuation work to determine the fair value of certain assets acquired and liabilities assumed. The

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results of operations and the provisional fair values of the acquired assets and liabilities assumed have been included in the accompanying condensed consolidated financial statements since the Emerging Threat Acquisition Date. Revenue from Emerging Threats was not material for the three months ended March 31, 2015, and due to the continued integration of the combined businesses, it was impractical to determine the earnings.

The total purchase price was $31,803, consisting of $28,141 paid in cash consideration, net of cash acquired of $52, and $3,662 to be paid in the second quarter of 2015. Of the cash consideration paid, $5,415 was held in escrow at the acquisition date and additional $585 will be transferred to escrow in the second quarter of 2015, to secure indemnification obligations, which has not been released as of the filing date of this Quarterly Report on Form 10-Q. The Company incurred $247 in acquisition-related costs which were recorded within operating expenses for the three months ended March 31, 2015.

Fair value of acquired assets and liabilities assumed

The determination of the fair values of the assets acquired and liabilities assumed has been prepared on a provisional basis and changes to that determination may occur as additional information becomes available. The following table summarizes the fair values of tangible and intangible assets acquired, liabilities assumed and goodwill:

	Estimated Fair Value	Estimated Useful Life (in years)
Current assets acquired	$934	N/A
Fixed assets acquired	174	N/A
Liabilities assumed	(448)	N/A
Deferred revenue assumed	(700)	N/A
Holdback liability to the sellers	(3,662)	N/A
Trade names	200	2
Customer relationships	4,200	7
Order Backlog	200	1
Developed technology	7,900	7
Goodwill	19,395	Indefinite
	$28,193	

Nexgate, Inc.

On October 31, 2014 (the "Nexgate Acquisition Date"), pursuant to the terms of an Agreement and Plan of Merger, a wholly-owned subsidiary of the Company merged with and into Nexgate, Inc. ("Nexgate"), with Nexgate surviving as a wholly-owned subsidiary of the Company. Formerly based in Burlingame, California, Nexgate provides cloud-based brand protection and compliance for enterprise social media accounts. With this acquisition, the Company's customers can effectively protect their online brand presence and social media communication infrastructure. Nexgate technology identifies and remediates fraudulent social media accounts, account hacks, and content that contains malware, spam and abusive language. In addition, the Nexgate solution enforces policy on authorized accounts and posts for compliance with a wide-range of social media regulatory requirements.

The Company has provisionally estimated the fair values for the acquired tangible and identifiable intangible assets and liabilities assumed at the Nexgate Acquisition Date. The amounts reported were considered provisional as the Company was completing the valuation work to determine the fair value of certain assets acquired and liabilities assumed.

The results of operations and the provisional fair values of the acquired assets and liabilities assumed have been included in the accompanying consolidated financial statements since the Nexgate Acquisition Date.

At the Nexgate Acquisition Date, the Company paid $31,771 in cash consideration, net of cash acquired of $1,032. Of the cash consideration paid, $5,250 was held in escrow to secure indemnification obligations, which has not been released as of the filing date of this Quarterly Report on Form 10-Q.

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Fair value of acquired assets and liabilities assumed

The determination of the fair values of the assets acquired and liabilities assumed has been prepared on a provisional basis and changes to that determination may occur as additional information becomes available. The following table summarizes the fair values of tangible assets acquired, liabilities assumed, intangible assets and goodwill:

	Estimated Fair Value	Estimated Useful Life (in years)
Current assets acquired	$ 1,340	N/A
Fixed assets acquired	15	N/A
Liabilities assumed	(64)	N/A
Deferred revenue assumed	(600)	N/A
Customer relationships	3,000	7
Order backlog	200	2
Developed technology	3,200	4
In-process research and development	900	N/A
Deferred tax liability, net	(792)	N/A
Goodwill	25,604	Indefinite
	$ 32,803	

NetCitadel, Inc.

On May 13, 2014 (the "NetCitadel Acquisition Date"), pursuant to the terms of an Agreement and Plan of Merger, a wholly-owned subsidiary of the Company merged with and into NetCitadel, Inc. ("NetCitadel"), with NetCitadel surviving as a wholly-owned subsidiary of the Company. Formerly based in Mountain View, California, NetCitadel is a pioneer in the field of automated security incident response. The acquisition extends the reach and capabilities of the Company's existing advanced threat solutions, adding additional threat verification and containment capabilities via an open platform that unifies products from the Company and other vendors.

The Company has provisionally estimated fair values for the acquired tangible and identifiable intangible assets and liabilities assumed at the NetCitadel Acquisition Date. The amounts reported were considered provisional as the Company was completing the valuation work to determine the fair value of certain assets acquired and liabilities assumed.

The results of operations and the provisional fair values of the acquired assets and liabilities assumed have been included in the accompanying consolidated financial statements since the NetCitadel Acquisition Date.

At the NetCitadel Acquisition Date, the Company paid $22,731. Of the cash consideration paid, $3,369 was held in escrow to secure indemnification obligations, which has not been released as of the filing date of this Form 10-Q.

Fair value of acquired assets and liabilities assumed

The determination of the fair values of the assets acquired and liabilities assumed has been prepared on a provisional basis and changes to that determination may occur as additional information becomes available. The following table summarizes the fair values of tangible assets acquired, liabilities assumed, intangible assets and goodwill:

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	Estimated Fair Value	Estimated Useful Life
Tangible assets acquired	$14	N/A
Liabilities assumed	(1,267)	N/A
Customer relationships	100	5
Developed technology	5,500	5
Goodwill	18,384	Indefinite
	$22,731	

Pro Forma Financial Information

The following unaudited pro forma financial information presents the combined results of operations for the three months ended March 31, 2015 and 2014 of the Company and Emerging Threats, assuming that Emerging Threats was acquired as of January 1, 2014. Adjustments were made to give effect to pro forma events that are directly attributable to the acquisitions such as amortization expense of acquired intangible assets, stock-based compensation directly attributable to the acquisition and acquisition-related transaction costs. The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings which may result from the consolidation of the operations of the Company and acquired Emerging Threats. Accordingly, these unaudited pro formas results are presented for informational purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the acquisitions had occurred at the beginning of the period presented, nor are they indicative of future results of operations:

	Three Months Ended March 31, 2015	2014
Total revenue	$57,770	$43,445
Net loss	(23,294)	(15,591)
Basic and diluted net loss per share	$(0.60)	$(0.43)

The unaudited pro forma financial information includes non-recurring acquisition-related transaction cost of $247 for the three months ended March 31, 2014.

3. Goodwill and Intangible Assets

The goodwill activity and balances are presented below:

Balance at December 31, 2014	$107,504
Add: Goodwill from acquisitions	19,395
Less: Other adjustments to Goodwill	(24)
Balance at March 31, 2015	$126,875

The goodwill balance as of March 31, 2015 was the result of the Company's acquisitions.

Intangible Assets

Intangible assets, excluding goodwill, consisted of the following:

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	March 31, 2015			December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$46,068	$(22,919)	$23,149	$38,168	$(21,538)	$16,630
Customer relationships	20,582	(9,062)	11,520	16,382	(7,893)	8,489
Non-compete agreements	804	(535)	269	804	(462)	342
Trade names and patents	1,006	(310)	696	806	(264)	542
Order backlog	400	(55)	345	200	(17)	183
In-process research and development	900	—	900	900	—	900
	$69,760	$(32,881)	$36,879	$57,260	$(30,174)	$27,086

Amortization expense of intangible assets totaled $2,707 and $1,960 for the three months ended March 31, 2015 and 2014, respectively.

Future estimated amortization costs of intangible assets as of March 31, 2015 are presented below:

Year ending December 31,	
2015, remainder	$8,666
2016	9,291
2017	5,944
2018	5,346
2019	2,982
Thereafter	4,650
	$36,879

4. Fair Value Measurements and Investments

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date. A hierarchy for inputs used in measuring fair value has been defined to minimize the use of unobservable inputs by requiring the use of observable market data when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on active market data. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances.

The fair value hierarchy prioritizes the inputs into three broad levels:

- Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities.

The Company’s Level 1 assets generally consist of money market funds.

- Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or 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 for substantially the full term of the asset or liability.

The Company’s Level 2 assets and liabilities generally consist of corporate debt securities, commercial papers, certificates of deposit and convertible senior notes.

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- Level 3: Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

The following tables summarize, for each category of assets or liabilities carried at fair value, the respective fair value as of March 31, 2015 and December 31, 2014 and the classification by level of input within the fair value hierarchy:

	Balance as of March 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets				
Cash equivalents:				
Money market funds	$127,388	$127,388	$—	$—
Short-term investments:				
Corporate debt securities	22,030	—	22,030	—
Commercial paper	1,500	—	1,500	—
Total financial assets	$150,918	$127,388	$23,530	$—

	Balance as of December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets				
Cash equivalents:				
Money market funds	$139,644	$139,644	$—	$—
Short-term investments:				
Corporate debt securities	31,651			