ServiceNow, Inc.
Form 10-Q
November 04, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
x Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013
OR
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-35580

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

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

ServiceNow, Inc.
3260 Jay Street
Santa Clara, California 95054
(408) 501-8550
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes x No ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x
As of September 30, 2013, there were approximately 138.7 million shares of the Registrant’s Common Stock outstanding.

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PART I

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$121,094	$118,989
Short-term investments	99,044	195,702
Accounts receivable, net	84,527	78,163
Current portion of deferred commissions	24,835	14,979
Prepaid expenses and other current assets	12,919	14,256
Total current assets	342,419	422,089
Deferred commissions, less current portion	16,716	11,296
Long-term investments	132,619	—
Property and equipment, net	68,642	42,342
Intangible assets, net	6,189	596
Goodwill	8,526	—
Other assets	3,625	1,791
Total assets	$578,736	$478,114
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$7,930	$9,604
Accrued expenses and other current liabilities	49,664	48,059
Current portion of deferred revenue	210,545	153,964
Total current liabilities	268,139	211,627
Deferred revenue, less current portion	15,256	16,397
Other long-term liabilities	7,745	6,685
Total liabilities	291,140	234,709
Stockholders' equity:		
Common stock	139	126
Additional paid-in capital	443,083	348,803
Accumulated other comprehensive loss	(662)	(36)
Accumulated deficit	(154,964)	(105,488)
Total stockholders' equity	287,596	243,405
Total liabilities and stockholders' equity	$578,736	$478,114

See accompanying notes to condensed consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues:				
Subscription	$92,992	$55,279	$244,926	$141,640
Professional services and other	18,267	9,066	54,494	26,910
Total revenues	111,259	64,345	299,420	168,550
Cost of revenues[(1)]:				
Subscription	23,429	17,931	61,960	43,182
Professional services and other	18,146	9,643	47,921	28,519
Total cost of revenues	41,575	27,574	109,881	71,701
Gross profit	69,684	36,771	189,539	96,849
Operating expenses[(1)]:				
Sales and marketing	47,336	28,140	137,853	74,356
Research and development	20,819	10,783	54,809	26,098
General and administrative	16,179	11,195	43,783	24,441
Total operating expenses	84,334	50,118	236,445	124,895
Loss from operations	(14,650)	(13,347)	(46,906)	(28,046)
Interest and other income (expense), net	600	615	(604)	1,148
Loss before provision for income taxes	(14,050)	(12,732)	(47,510)	(26,898)
Provision for income taxes	663	321	1,966	519
Net loss	$(14,713)	$(13,053)	$(49,476)	$(27,417)
Net loss attributable to common stockholders - basic and diluted	$(14,713)	$(13,053)	$(49,476)	$(27,725)
Net loss per share attributable to common stockholders - basic and diluted	$(0.11)	$(0.11)	$(0.37)	$(0.49)
Weighted-average shares used to compute net loss per share attributable to common stockholders - basic and diluted	137,456,531	117,698,005	134,036,466	57,089,411
Other comprehensive income (loss):				
Foreign currency translation adjustments	$758	$57	$(608)	$(479)
Unrealized gain (loss) on investments	412	(17)	(18)	(34)
Provision for income taxes	—	—	—	60
Other comprehensive income (loss), net of tax	1,170	40	(626)	(573)
Comprehensive loss	$(13,543)	$(13,013)	$(50,102)	$(27,990)

(1) Includes stock-based compensation as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Cost of revenues:				
Subscription	$2,190	$1,276	$5,980	$2,514
Professional services and other	1,209	495	3,095	964
Sales and marketing	5,945	2,899	14,752	6,852

Research and development	4,176	1,919	11,005	4,121
General and administrative	4,331	1,624	9,893	4,137

See accompanying notes to condensed consolidated financial statements

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

	Nine Months Ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net loss	$(49,476)	$(27,417)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	16,316	8,841
Amortization of premiums on investments, net	3,441	594
Amortization of deferred commissions	19,825	9,264
Stock-based compensation	44,725	18,588
Tax benefit from exercise of stock options	(1,817)	(533)
Bad debt expense	882	148
Lease abandonment costs	354	2,922
Changes in operating assets and liabilities:		
Accounts receivable	(6,988)	(11,065)
Deferred commissions	(34,894)	(20,525)
Prepaid expenses and other current assets	2,827	4,242
Other assets	(1,750)	(35)
Accounts payable	(408)	(106)
Accrued expenses and other current liabilities	(2,646)	4,189
Deferred revenue	54,332	43,081
Other long-term liabilities	756	(93)
Net cash provided by operating activities	45,479	32,095
Cash flows from investing activities:		
Purchases of property and equipment	(39,059)	(32,156)
Acquisition, net of cash acquired	(13,330)	—
Purchases of investments	(233,444)	(146,922)
Sale of investments	50,403	1,025
Maturities of investments	142,456 (1)	5,800
Restricted cash	(174)	8
Net cash used in investing activities	(93,148)	(172,245)
Cash flows from financing activities:		
Net proceeds from initial public offering	—	169,799
Offering costs in connection with follow-on offering	(698)	—
Proceeds from employee stock plans	47,833	2,349
Proceeds from early exercise of stock options	—	1,024
Tax benefit from exercise of stock options	1,817	533
Net proceeds from issuance of common stock	—	17,848
Purchases of common stock and restricted stock from stockholders	—	(1,960)
Net cash provided by financing activities	48,952	189,593
Foreign currency effect on cash and cash equivalents	822	(555)
Net increase in cash and cash equivalents	2,105	48,888
Cash and cash equivalents at beginning of period	118,989	68,088
Cash and cash equivalents at end of period	$121,094	$116,976
Supplemental disclosures of non-cash investing activities:		

Property and equipment included in accounts payable and accrued expenses	$5,360	$3,768

(1) Maturities of investments include the effect of the correction of an immaterial error of $3.0 million related to securities that were improperly classified as short-term investments instead of cash and cash equivalents as of December 31, 2012.

See accompanying notes to condensed consolidated financial statements

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

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

(1) Description of the Business

ServiceNow is a leading provider of cloud-based services to automate enterprise IT operations. We focus on transforming enterprise IT by automating and standardizing service relationships and consolidating IT across the global enterprise. Organizations deploy our service to create a single system of record for enterprise IT, lower operational costs and enhance efficiency. Additionally, our customers use our extensible platform to build custom applications both for IT and other functions across the enterprise, thereby facilitating the automation of activities unique to their business requirements.

(2) Summary of Significant Accounting Policies

Basis of Presentation
The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for fair statement have been included. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the year ended December 31, 2013 or for other interim periods or for future years. The condensed consolidated balance sheet as of December 31, 2012 is derived from audited financial statements as of that date, however, does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Form 10-K for the fiscal year ended December 31, 2012, which was filed with the Securities and Exchange Commission on March 8, 2013.

Principles of Consolidation

The condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles, or GAAP, and include our accounts and the accounts of our wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Items subject to the use of estimates include revenue recognition, allowance for trade accounts receivable, accrual for service level credits, useful lives of fixed assets, certain accrued liabilities including our facility exit obligation, the determination of the provision for income taxes, the fair value of stock awards, loss contingencies and the fair value of assets acquired and liabilities assumed for business combinations.

Foreign Currency Translation

The functional currencies for our foreign subsidiaries are primarily their local currencies. Assets and liabilities of the wholly-owned foreign subsidiaries are translated into U.S. dollars at exchange rates in effect at each period end. Amounts classified in stockholders' equity are translated at historical exchange rates. Revenues and expenses are translated at the average exchange rates during the period. The resulting translation adjustments are recorded in accumulated other comprehensive loss as a component of stockholders' equity. Foreign currency transaction gains and losses are included in interest and other income (expense), net within the condensed consolidated statements of comprehensive loss.

Revenue Recognition

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We derive our revenues from two sources: (i) subscriptions and (ii) professional services and other. Subscription revenues are primarily comprised of subscription fees that give customers access to the ordered subscription service and related support and include updates to the subscribed service during the subscription term.

Our contracts typically do not give the customer the right to take possession of the software supporting the solution. Professional services and other revenues consist of fees associated with the implementation and configuration of our service. Professional services and other revenues also include customer training and attendance and sponsorship fees for Knowledge, our annual user conference.

We commence revenue recognition when all of the following conditions are met:

- There is persuasive evidence of an arrangement;
- The service has been provided to the customer;
- The collection of related fees is reasonably assured; and
- The amount of fees to be paid by the customer is fixed or determinable.

We use a signed contract together with either a signed order form or a purchase order, as evidence of an arrangement for a new customer. In subsequent transactions with an existing customer, including an upsell or a renewal, we consider the existing signed contract and either the new signed order form or new purchase order as evidence of an arrangement.

We recognize subscription revenues ratably over the contract term beginning on the commencement date of each contract, which is the date we make our service available to our customers. Once our service is available to customers, we record amounts due in accounts receivable and in deferred revenue. We price our professional services primarily on a time-and-materials basis. We recognize professional services and other revenues as the services are delivered using a proportional performance model. Such services are delivered over a short period of time. In instances where final acceptance of the services are required before revenues are recognized, we defer professional services revenues and the associated costs until all acceptance criteria have been met.

We assess collectibility based on a number of factors such as past collection history with the customer and creditworthiness of the customer. If we determine collectibility is not reasonably assured, we defer revenue recognition until collectibility becomes reasonably assured. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. Our arrangements do not include general rights of return.

We have multiple element arrangements comprised of subscription fees and professional services. We account for subscription and professional services revenues as separate units of accounting. To qualify as a separate unit of accounting, the delivered item must have value to the customer on a standalone basis. We have concluded that our subscription service has standalone value as it is routinely sold separately by us. In addition, the applications offered through this subscription service are fully functional without any additional development, modification or customization. We provide customers access to our subscription service at the beginning of the contract term. In determining whether professional services have standalone value, we considered the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date and the contractual dependence of the subscription service on the customer's satisfaction with the professional services work. Our professional services, including implementation and configuration services, are not so unique and complex that other vendors cannot provide them. In some instances, customers independently contract with third-party vendors to do the implementation and we regularly outsource implementation services to contracted third-party vendors. As a result, we concluded professional services, including implementation and configuration

services, have standalone value.

We determine the selling price of each deliverable in the arrangement using the selling price hierarchy. Under the selling price hierarchy, the selling price for each deliverable is determined using vendor-specific objective evidence, or VSOE, of selling price or third-party evidence, or TPE, of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, the selling price is determined using the best estimate of selling price, or BESP. The selling price for each unit of account is based on the BESP since VSOE and TPE are not available for our subscription service or professional services and other. The BESP for each deliverable is determined primarily by considering the historical selling price of these deliverables in similar transactions as well as other factors, including, but not limited to, market competition, review of stand-alone sales and current pricing practices. In determining the appropriate pricing structure, we consider the extent of competitive pricing of similar products and marketing analyses. The total arrangement fee for these multiple element arrangements is then allocated to the separate units of account based on the relative selling price. We price our subscription service using a scaled model based on the duration of the subscription term and we frequently extend discounts to our customers based on the number of users.

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In limited circumstances, we grant certain customers the right to deploy our subscription service on the customers' own servers without significant penalty. We have analyzed all of the elements in these particular multiple element arrangements and determined we do not have sufficient VSOE of fair value to allocate revenue to our subscription service and professional services. We defer all revenue under the arrangement until the last element in the transaction has been delivered or started to be delivered. Once the subscription service and the associated professional services have commenced, the entire fee from the arrangement is recognized ratably over the remaining period of the arrangement.

Deferred Revenue

Deferred revenue consists primarily of payments received in advance of revenue recognition for our subscriptions and professional services and other revenues and is recognized as the revenue recognition criteria are met. We generally invoice our customers in annual installments for our subscription service. Accordingly, the deferred revenue balance does not represent the total contract value of annual or multi-year subscription license agreements. Deferred revenue that will be recognized during the succeeding 12-month period is recorded as current portion of deferred revenue and the remaining portion is recorded as long-term.

Deferred Commissions

Deferred commissions are the incremental costs that are directly associated with our non-cancelable subscription contracts with customers and consist of sales commissions paid to our direct sales force and referral fees paid to independent third-parties. The majority of commissions and referral fees are deferred and amortized on a straight-line basis over the non-cancelable terms of the related customer contracts. Amortization of deferred commissions is included in sales and marketing expense in the condensed consolidated statements of comprehensive loss.

Fair Value Measurements

We apply fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. 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 the asset or liability in an orderly transaction between market participants on the measurement date. We use a fair value hierarchy that is based on three levels of inputs, of which the first two are considered observable and the last unobservable. The three levels of the fair value hierarchy are as follows:

Level 1—Quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access;

Level 2—Inputs other than Level 1 that are directly or indirectly observable, such as quoted prices for identical or similar assets and liabilities, quoted prices 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 assets or liabilities, such as interest rates, yield curves and foreign currency spot rates; and

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

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less. Cash and cash equivalents are stated at fair value.

Investments

Investments consist of commercial paper, corporate notes and bonds and U.S. government agency securities. We classify investments as available-for-sale at the time of purchase and reevaluate such classification as of each balance sheet date. All investments are recorded at estimated fair value. Unrealized gains and losses for available-for-sale securities are in accumulated other comprehensive income (loss), a component of stockholders' equity. We evaluate our investments to assess whether those with unrealized loss positions are other than temporarily impaired. We consider impairments to be other than temporary if they are related to deterioration in credit risk or if it is likely we will sell the securities before the recovery of their cost basis. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in interest and other income (expense), net in the condensed consolidated statements of comprehensive loss.

Accounts Receivable

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We record trade accounts receivable at the net invoice value and such receivables are non-interest bearing. We consider receivables past due based on the contractual payment terms. We review our exposure to accounts receivable and reserve for specific amounts if collectibility is no longer reasonably assured.

Property and Equipment

Property and equipment, net, are stated at cost, subject to review of impairment, and depreciated using the straight-line method over the estimated useful lives of the assets as follows:

Computer equipment and software	3—5 years
Furniture and fixtures	3—5 years
Leasehold improvements	shorter of the lease term or estimated useful life

When assets are sold, or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is included in operating expenses. Repairs and maintenance are charged to operations as incurred.

Capitalized Software Costs

Costs incurred to develop our internal administration, finance and accounting systems are capitalized during the application development stage and amortized over the software's estimated useful life of three to five years.

Leases

Leases are reviewed and classified as capital or operating at their inception. For leases that contain rent escalations or periods during the lease term where rent is not required, we recognize rent expense based on allocating the total rent payable on a straight-line basis over the term of the lease excluding lease extension periods. The difference between rent payments and straight-line rent expense is recorded as deferred rent in the condensed consolidated balance sheets. Deferred rent that will be recognized during the succeeding 12-month period is recorded as the current portion of deferred rent and the remainder is recorded as long-term deferred rent.

Under certain leases, we also receive incentives for leasehold improvements, which are recognized as deferred rent, if we determine they are owned by us, and amortized on a straight-line basis over the shorter of the lease term or estimated useful life as a reduction to rent expense. The leasehold improvements are included in property and equipment, net.

Goodwill, Intangible Assets and Impairment Assessments

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. We evaluate and test the recoverability of its goodwill for impairment at least annually, or more frequently if circumstances indicate that goodwill may not be recoverable.

Intangible assets are amortized over their useful lives. Each period we evaluate the estimated remaining useful life of purchased intangible assets to determine whether events or changes in circumstances warrant a revision to the remaining period of amortization.

The carrying amounts of these assets are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of each asset to the future undiscounted cash flows the asset is

expected to generate.

Stock-based Compensation

We recognize compensation expense related to stock options and restricted stock units, or RSUs, on a straight-line basis over the requisite service period, which is generally the vesting term of four years. We recognize compensation expense related to shares issued pursuant to the employee stock purchase plan, or ESPP, on a straight-line basis over the offering period. Compensation expense is recognized, net of forfeiture activity estimated to be 4% annually. We estimate the fair value of options using the Black-Scholes options pricing model and fair value of restricted stock unit awards using the value of our common stock on the date of grant. Refer to Note 11 for further information.

Net Income (Loss) Per Share Attributable to Common Stockholders

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We compute net income attributable to common stockholders using the two-class method required for participating securities. We consider our convertible preferred stock that was outstanding prior to the close of our initial public offering and shares of common stock subject to repurchase resulting from the early exercise of stock options to be participating securities since they contain non-forfeitable rights to dividends or dividend equivalents in the event we declare a dividend for common stock. In accordance with the two-class method, earnings allocated to these participating securities are subtracted from net income after deducting preferred stock dividends and accretion to the redemption value of the Series A, Series B and Series C to determine total undistributed earnings to be allocated to common stockholders. The holders of our convertible preferred stock did not have a contractual obligation to share in our net losses and such shares were excluded from the computation of basic earnings per share in periods of net loss.

Basic net income (loss) per share attributable to common stockholders is computed by dividing net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding during the period. All participating securities are excluded from basic weighted-average common shares outstanding. Diluted net income (loss) per share is computed by dividing net income (loss) attributable to common stockholders by the weighted-average number of shares of common stock outstanding during the period, adjusted for the effects of dilutive common shares, which are comprised of outstanding common stock options, RSUs, common stock subject to repurchase and ESPP obligations. The dilutive potential common shares are computed using the treasury stock method. The effects of outstanding common stock options, RSUs, common stock subject to repurchase and ESPP obligations are excluded from the computation of diluted net income (loss) per common share in periods in which the effect would be antidilutive.

Concentration of Credit Risk and Significant Customers

Financial instruments potentially exposing us to credit risk consist primarily of cash equivalents, investments and accounts receivable. We maintain cash, cash equivalents and investments at financial institutions that management believes to have good credit ratings and represent minimal risk of loss of principal. We invest in securities with a minimum rating of A by Standard & Poor's and A-2 by Moody's.

Credit risk arising from accounts receivable is mitigated due to our large number of customers and their dispersion across various industries and geographies. As of September 30, 2013 and December 31, 2012, there were no customers that represented more than 10% of our accounts receivable balance. During the three and nine months ended September 30, 2013 and 2012, there were no customers that individually exceeded 10% of our revenues.

We review the composition of the accounts receivable balance, historical write-off experience and the potential risk of loss associated with delinquent accounts to determine if an allowance for doubtful accounts is necessary. Individual accounts receivable are written off when we become aware of a specific customer’s inability to meet its financial obligation and all collection efforts are exhausted. As of September 30, 2013 and December 31, 2012, the allowance for doubtful accounts was $0.5 million and $0.7 million, respectively.

Warranties and Indemnification

Our cloud-based service to automate enterprise IT operations is typically warranted to perform in material conformance with specifications.

We include service level commitments to our customers that permit those customers to receive credits in the event we fail to meet those levels. We establish an accrual based on historical credits paid and an evaluation of the performance of our services including an assessment of the impact, if any, of any known service disruptions. As of September 30, 2013 and December 31, 2012, the service level credit accrual was $0.8 million and $1.2 million, respectively.

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

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

Income Taxes

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We use the asset and liability method of accounting for income taxes in which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the condensed consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be reversed. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date. A valuation allowance is established if it is more likely than not that all or a portion of the deferred tax asset will not be realized.

Recent Accounting Pronouncements

In July 2013, the FASB issued a new accounting standard update on the financial statement presentation of unrecognized tax benefits. The new guidance provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward, if such settlement is required or expected in the event the uncertain tax position is disallowed. The new guidance becomes effective for us on January 1, 2014 and it should be applied prospectively to unrecognized tax benefits that exist at the effective date with retrospective application permitted. We are currently assessing the impact of this new guidance.

(3) Investments

The following is a summary of our investments (in thousands):

	September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Commercial paper	$55,898	$2	$—	$55,900
Corporate notes and bonds	215,199	43	(168)	215,074
Total available-for-sale securities	$271,097	$45	$(168)	$270,974

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Commercial paper	$72,850	$—	$(15)	$72,835
Corporate notes and bonds	158,038	8	(98)	157,948
U.S. government agency securities	1,001	—	—	1,001
Total available-for-sale securities	$231,889	$8	$(113)	$231,784

As of September 30, 2013, the contractual maturities of our investments did not exceed 24 months. The fair values of available-for-sale investments, by contractual maturity, are as follows:

	September 30, 2013
Due in 1 year or less	$138,355
Due in 1 year through 3 years	132,619
Total	$270,974

As of September 30, 2013 and December 31, 2012, we had certain available-for-sale securities in a gross unrealized loss position, all of which had been in such position for less than twelve months. There were no impairments considered other-than-temporary as it is more likely than not we will hold the securities until maturity or a recovery of the cost basis. The following table shows the fair values and the gross unrealized losses of these available-for-sale securities aggregated by investment types (in thousands):

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	September 30, 2013		December 31, 2012	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Commercial paper	$—	$—	$36,753	$(15)
Corporate notes and bonds	164,230	(168)	137,558	(98)
Total	$164,230	$(168)	$174,311	$(113)

(4) Acquisition

On July 1, 2013, we acquired all the outstanding stock of Mirror42 Holding B.V., a cloud-based performance analytics company, for total cash consideration of $13.3 million. The acquisition accelerates our ability to deliver on enterprise requirements for advanced business intelligence.

The following table summarizes the allocation of the purchase price to the fair value of the tangible and intangible assets acquired and liabilities assumed as of the acquisition date:

	Purchase Price Allocation (in thousands)	Useful Lives (in years)
Net tangible liabilities acquired	$(595)	
Intangible assets:		
Developed technology	5,530	4
Contracts	297	1.5
Non-compete agreements	31	1.5
Goodwill	8,218	
Net deferred tax liabilities	(139)	
Total purchase price	$13,342	

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Management believes that the goodwill represents the synergies expected from expanded market opportunities when integrating the Mirror42 Holding B.V.’s technologies with our offerings. The goodwill balance is not deductible for U.S. income tax purposes.

The results of operations of Mirror42 Holding B.V. described above have been included in our condensed consolidated financial statements from the date of purchase. Our business combination did not have a material impact on our condensed consolidated financial statements, and therefore pro forma disclosures have not been presented.

(5) Goodwill and Intangible Assets

Goodwill balance as of September 30, 2013 and December 31, 2012 is presented below (in thousands):

	Carrying Amount
Balance as of December 31, 2012	$—
Goodwill acquired	8,218
Foreign currency translation adjustments	308
Balance as of September 30, 2013	$8,526

Intangible assets consisted of the following as of September 30, 2013 and December 31, 2012 (in thousands):

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	September 30, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$5,737	$(358)	$5,379
Contracts	308	(51)	257
Non-compete agreements	32	(5)	27
Acquisition-related intangible assets	6,077	(414)	5,663
Other intangible assets	650	(124)	526
Total intangible assets	$6,727	$(538)	$6,189

	December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Other intangible assets	$650	$(54)	$596
Total intangible assets	$650	$(54)	$596

Amortization expense for intangible assets for the three months ended September 30, 2013 and 2012 was approximately $439,000 and $23,000, respectively, and for the nine months ended September 30, 2013 and 2012 was approximately $484,000 and $31,000, respectively.

(6) Property and Equipment

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

	September 30, 2013	December 31, 2012
Computer equipment and software	$83,406	$46,541
Furniture and fixtures	9,084	4,691
Leasehold improvements	4,924	2,649
Construction in progress	2,647	4,855
	100,061	58,736
Less: Accumulated depreciation	(31,419)	(16,394)
Total property and equipment, net	$68,642	$42,342

Construction in progress consists primarily of in-process software development costs. Depreciation expense for the three months ended September 30, 2013 and 2012 was $6.2 million and $3.9 million, respectively, and for the nine months ended September 30, 2013 and 2012 was $15.8 million and $8.8 million, respectively.

(7) Accrued Expenses and Other Current Liabilities

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

	September 30, 2013	December 31, 2012
Bonuses and commissions	$15,001	$10,999
Accrued compensation	11,630	18,392
Other employee expenses	6,807	7,796
Current portion of facility exit obligation	1,252	1,515

Other	14,974	9,357
Total accrued expenses and other current liabilities	$49,664	$48,059

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(8) Accumulated Other Comprehensive Loss

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

	September 30, 2013	December 31, 2012
Foreign currency translation adjustment	$(539)	$69
Net unrealized loss on investments	(123)	(105)
Accumulated other comprehensive loss, net of tax	$(662)	$(36)

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

(9) Fair Value Measurements

The following table presents our fair value hierarchy for our assets and liabilities measured at fair value on a recurring basis at September 30, 2013 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Cash	$45,694	$—	$—	45,694
Money market funds	36,089	—	—	36,089
Commercial paper	—	39,311	—	39,311
Short-term investments:				
Commercial paper	—	16,589	—	16,589
Corporate notes and bonds	—	82,455	—	82,455
Long-term investments:				
Corporate notes and bonds	—	132,619	—	132,619
Total	$81,783	$270,974	$—	$352,757

The following table presents our fair value hierarchy for our assets and liabilities measured at fair value on a recurring basis at December 31, 2012 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Cash	$47,478	$—	$—	$47,478
Money market funds	35,429	—	—	35,429
Commercial paper	—	36,082	—	36,082
Short-term investments:				
Commercial paper	—	36,753	—	36,753
Corporate notes and bonds	—	157,948	—	157,948
U.S. government agency securities	—	1,001	—	1,001
Total	$82,907	$231,784	$—	$314,691

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

(10) Common Stock

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We are authorized to issue 600,000,000 shares of common stock as of September 30, 2013. Holders of our common stock are not entitled to receive dividends unless declared by our board of directors.

As of September 30, 2013, we had 138,736,768 shares of common stock outstanding and had reserved shares of common stock for future issuance as follows:

	September 30, 2013
Stock option plans:	
Options outstanding	25,453,497
RSUs	4,755,522
Stock awards available for future grants:	
2005 Stock Option Plan[(1)]	—
2012 Equity Incentive Plan[(1)]	13,405,017
2012 Employee Stock Purchase Plan[(1)]	5,549,918
Total reserved shares of common stock for future issuance	49,163,954

(1) Refer to Note 11 for a description of these plans.

(11) Stock Awards

We have a 2005 Stock Option Plan, or 2005 Plan, which provides for grants of stock awards, including options to purchase shares of common stock, stock purchase rights and RSUs to certain employees, officers, directors and consultants. As of September 30, 2013, there were 54,517,674 total shares of common stock authorized for issuance under the 2005 Plan, which includes shares already issued under such plan and shares reserved for issuance pursuant to outstanding options and RSUs.

Our 2012 Equity Incentive Plan, or 2012 Plan, provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock awards, RSUs, performance-based stock awards and other forms of equity compensation, or collectively, stock awards. In addition, the 2012 Plan provides for the grant of performance cash awards. Incentive stock options may be granted only to employees. All other awards may be granted to employees, including officers, as well as directors and consultants. The share reserve may increase to the extent that outstanding stock options under the 2005 Plan expire or terminate unexercised. The share reserve also automatically increases on January 1 of each year until January 1, 2022, by up to 5% of the total number of shares of the common stock outstanding on December 31 of the preceding calendar year as determined by the board of directors. As of September 30, 2013, there were 20,981,151 total shares of common stock authorized for issuance under the 2012 Plan.

Our 2012 Employee Stock Purchase Plan, or 2012 ESPP, authorizes the issuance of shares of common stock pursuant to purchase rights granted to our employees. The number of shares of common stock reserved for issuance automatically increases on January 1 of each calendar year until January 1, 2022, by up to 1% of the total number of shares of the common stock outstanding on December 31 of the preceding calendar year. The price at which common stock is purchased under the 2012 ESPP is equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. Offering periods are six months long and begin on February 1 and August 1 of each year. As of September 30, 2013, we had 6,263,677 total shares of common stock reserved for issuance under the 2012 ESPP.

Stock Options

The stock options are exercisable at a price equal to the market value of the underlying shares of common stock on the date of the grant as determined by our board of directors or, for those stock options issued subsequent to our IPO, the closing price of our common stock as reported on the New York Stock Exchange on the date of grant. Stock options

granted under our 2005 Plan and the 2012 Plan to new employees generally vest 25% one year from the date the requisite service period begins and continue to vest monthly for each month of continued employment over the remaining three years. Options granted generally are exercisable for a period of up to 10 years. Option holders under the 2005 Plan can exercise unvested options to acquire restricted stock. Upon termination of service, we have the right to repurchase at the original purchase price any unvested (but issued) shares of common stock.

A summary of the stock option activity for the nine months ended September 30, 2013 is as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2012	36,115,460	$5.05		
Granted	1,936,206	35.21		
Exercised	(11,388,760)	3.00		$371,796
Cancelled	(1,209,409)	8.13		
Outstanding at September 30, 2013	25,453,497	$8.12	7.92	$1,115,754
Vested and expected to vest as of September 30, 2013	24,857,489	$7.96	7.87	$1,093,387
Vested and exercisable as of September 30, 2013	8,989,834	$4.25	7.29	$428,779

Aggregate intrinsic value represents the difference between the estimated fair value of our common stock and the exercise price of outstanding, in-the-money options. The weighted-average grant date fair value per share of options granted and vested were $17.33 and $3.61, respectively, for the nine months ended September 30, 2013. The total fair value of shares vested was $26.1 million for the nine months ended September 30, 2013.

As of September 30, 2013, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options was approximately $77.3 million. The weighted-average remaining vesting period of unvested stock options at September 30, 2013 was 2.63 years.

Under our 2005 Plan, we issue shares of restricted stock as a result of the cash exercise of unvested stock options. The proceeds initially are recorded as a liability from the early exercise of stock options and reclassified to common stock as our repurchase right lapses. A summary of the restricted stock activity for the nine months ended September 30, 2013 is as follows:

	Shares Outstanding	Weighted-Average Grant Date Fair Value
Balance at December 31, 2012	235,066	$1.49
Vested	(116,103)	1.59
Balance at September 30, 2013	118,963	$1.39

RSUs

	Number of Shares	Weighted- Average Grant Date Fair Value	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2012	1,457,870	$16.89	
Granted	3,719,856	34.95	
Vested	(266,903)	11.13	$10,622
Forfeited	(155,301)	33.92	
Outstanding at September 30, 2013	4,755,522	$30.60	$247,049
Expected to vest as of September 30, 2013	4,396,974		$228,423

RSUs granted under the 2005 Plan and the 2012 Plan to employees generally vest annually over a four-year period. As of September 30, 2013, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested RSUs was approximately $118.1 million and the weighted-average remaining vesting period was 3.59 years.

(12) Stock-Based Compensation

We use the Black-Scholes options pricing model to estimate the fair value of our stock-based awards. This model incorporates various assumptions including expected volatility, expected term, risk-free interest rates and expected dividend yields. The following weighted-average assumptions were used for each respective period to calculate our stock-based compensation for each stock option grant:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Stock Options:				
Expected volatility	51% - 52%	54%	51% - 52%	54% - 57%
Expected term (in years)	6.08	6.05	6.01	6.05
Risk-free interest rate	1.71% - 2.05%	0.87% - 0.93%	0.91% - 2.05%	0.87% - 1.18%
Dividend yield	—	—	—	—

The following weighted-average assumptions were used to calculate our stock-based compensation for each stock purchase right granted under the 2012 ESPP:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
ESPP:				
Expected volatility	35% - 39%	42 %	35% - 42%	42 %
Expected term (in years)	0.50	0.58	0.50	0.58
Risk-free interest rate	0.08% - 0.11%	0.16 %	0.08% - 0.16%	0.16 %
Dividend yield	—	—	—	—

Expected volatility. We use the historic volatility of publicly traded peer companies as an estimate for expected volatility. In considering peer companies, characteristics such as industry, stage of development, size and financial leverage are considered. We intend to continue to consistently apply this process using the same or similar public companies until a sufficient amount of historical information regarding the volatility of our own common stock share price becomes available.

Expected term. We estimate the expected term using the simplified method due to the lack of historical exercise activity for our company. The simplified method calculates the expected term as the mid-point between the vesting date and the contractual expiration date of the award.

Risk-free interest rate. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the stock-based award.

Expected dividend yield. Our expected dividend yield is zero, as we have not and do not currently intend to declare dividends in the foreseeable future.

Expected forfeiture rate. We consider our pre-vesting forfeiture history to determine our expected forfeiture rate.

Fair value of common stock. Prior to our initial public offering in June 2012, the fair value of our common stock was determined by our board of directors, which intended all options granted to be exercisable at a price per share not less than the per share fair value of the common stock underlying those options on the date of grant. The valuations of our common stock were determined in accordance with the guidelines outlined in the American Institute of Certified Public Accountants Practice Aid, Valuation of Privately-Held-Company Equity Securities Issued as Compensation. The assumptions used in the valuation model are based on future expectations combined with management judgment.

For stock options granted subsequent to our initial public offering, the fair value is based on the closing price of our common stock as reported on the New York Stock Exchange on the date of grant.

(13) Net Loss Per Share Attributable to Common Stockholders

The following tables present the calculation of basic and diluted net income (loss) per share attributable to common stockholders (in thousands, except share and per share data):

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net loss	$(14,713)	$(13,053)	$(49,476)	$(27,417)
Accretion of redeemable convertible preferred stock	—	—	—	(308)
Net loss attributable to common stockholders—basic and diluted	$(14,713)	$(13,053)	$(49,476)	$(27,725)
Denominator:				
Weighted-average shares outstanding—basic and diluted	137,456,531	117,698,005	134,036,466	57,089,411
Net loss per share attributable to common stockholders:				
Basic	$(0.11)	$(0.11)	$(0.37)	$(0.49)
Diluted	$(0.11)	$(0.11)	$(0.37)	$(0.49)

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

	September 30,	
	2013	2012
Common stock options	25,453,497	37,279,442
Restricted stock units	4,755,522	1,134,851
Common stock subject to repurchase	118,963	349,165
ESPP obligations	236,006	468,704
Total potentially dilutive securities	30,563,988	39,232,162

(14) Income Taxes

We compute our provision for income taxes by applying the estimated annual effective tax rate to income from recurring operations and adjust the provision for discrete tax items recorded in the period. Our effective tax rate for the three and nine months ended September 30, 2013 was (5)% and (4)% respectively, which was lower than the federal statutory tax rate of 34%. The lower tax rate was primarily attributable to our loss from operations, a foreign tax rate differential and non-deductible expenses arising from stock-based compensation, partially offset by state income taxes.

Our effective tax rate for the three and nine months ended September 30, 2012 was (3)% and (2)%, respectively. The lower tax rate was primarily attributable to our loss from operations, a foreign tax rate differential and non-deductible expenses arising from stock-based compensation, partially offset by state income taxes and California tax credits.

We are currently under examination by the Internal Revenue Service for the year ended June 30, 2011 and six months ended December 31, 2011. There are differing interpretations of tax laws and regulations, and as a result, disputes may arise with these tax authorities involving issues of the timing and amount of deductions and allocations of income among various tax jurisdictions. We periodically evaluate our exposures associated with our tax filing positions.

We record liabilities related to uncertain tax positions in accordance with the income tax guidance which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by prescribing a minimum recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We believe we have provided adequate reserves for our income tax uncertainties in all open tax years.

(15) Commitments and Contingencies

Leases

We lease facilities for data center capacity and office space under non-cancelable operating lease agreements with various expiration dates. Annual future minimum payments under these operating leases as of September 30, 2013 (in thousands) are

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presented in the table below. Included in the table below are future minimum lease payments under non-cancelable subleases as of September 30, 2013 of $3.8 million.

	Data Centers	Office Leases	Total
Fiscal Period:			
Remaining three months ended December 31, 2013	$2,534	$1,468	$4,002
2014	12,110	10,473	22,583
2015	4,713	12,946	17,659
2016	1,193	13,303	14,496
2017	57	13,537	13,594
Thereafter	—	53,541	53,541
Total minimum lease payments	$20,607	$105,268	$125,875

Lease commitments of $8.8 million related to the lease for our former San Diego office, which we exited in 2012, are included in the table above.

Legal Proceedings

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

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

(16) Information about Geographic Areas

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues by geography:				
North America	$76,851	$45,509	$208,851	$120,124
EMEA [(1)]	27,621	16,133	72,403	42,027
Asia Pacific and other	6,787	2,703	18,166	6,399
Total revenues	$111,259	$64,345	$299,420	$168,550

(1) Europe, the Middle East and Africa, or EMEA

Long-lived assets by geographic area were as follows (in thousands):

	September 30, 2013	December 31, 2012
Long-lived assets:		

North America	$47,086	$30,209
EMEA	17,970	10,513
Asia Pacific and other	3,586	1,620
Total long-lived assets	$68,642	$42,342

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

The following discussion and analysis of our financial condition, results of operations and cash flows should be read in conjunction with the (1) unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q, and (2) the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the fiscal year ended December 31, 2012 included in the form 10-K dated as of, and filed with the Securities and Exchange Commission, or the SEC, on March 8, 2013 (File No. 001-35580). This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and similar expressions or variations. Such forward-looking statemer are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled "Risk Factors", set forth in Part II, Item 1A of this Form 10-Q and in our other SEC filings. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

ServiceNow is a leading provider of cloud-based services to automate enterprise IT operations. We focus on transforming enterprise IT by automating and standardizing service relationships and consolidating IT across the global enterprise. Organizations deploy our service to create a single system of record for enterprise IT, lower operational costs and enhance efficiency. Additionally, our customers use our extensible platform to build custom applications both for IT and other functions across the enterprise, thereby facilitating the automation of activities unique to their business requirements.

We offer our service under a SaaS business model. Our subscription fees include access to the ordered subscription service and related support and include updates of the subscribed service during the subscription term. We provide a scaled pricing model based on the duration of the subscription term and we frequently extend discounts to our customers based on the number of users. We generate sales through our direct sales team and indirectly through channel partners and third-party referrals. We also generate revenues from professional services for implementation and training of customer personnel. We generally bill our customers annually in advance for subscription services and monthly in arrears for our professional services as the work is performed.

Many customers initially subscribe to our service to solve a specific and immediate problem. Once their problem is solved, many of our customers deploy additional applications as they become more familiar with our service and apply it to new IT processes. In addition, many customers either repurpose our IT applications or build custom applications that automate various processes for business uses outside of IT such as human resources, facilities and quality control management. A majority of our revenues come from large global enterprise customers.

To date, we have funded our business primarily with cash flows from operations. We continue to invest in the development of our service, infrastructure and sales and marketing to drive long-term growth. We increased our overall employee headcount to 1,654 as of September 30, 2013 from 963 as of September 30, 2012.

Key Factors Affecting Our Performance

Total customers. We believe our total customer count is a key indicator of our market penetration, growth and future revenues. We have aggressively invested in, and intend to continue to invest in, our direct sales force and additional partnerships within our indirect sales channel. We generally define a customer as an entity with an active service contract as of the measurement date. In situations where there is a single contract that applies to entities with multiple subsidiaries or divisions, universities, or governmental organizations, each entity that has contracted for a separate production instance of our service is counted as a separate customer. As of September 30, 2013 and 2012, our total customer count was 1,900 and 1,346, respectively.

Upsells. To grow our business it is important for us to generate additional sales from existing customers, which we refer to as our upsell rate. We calculate our upsell rate as the annual contract value of upsells signed during the period, net of any decreases in annual contract value of renewals during the period, divided by our total annual contract value signed during the period. The upsell rate was 29% and 20% for the three months ended September 30, 2013 and 2012, respectively, and 29% for both the nine months ended September 30, 2013 and 2012. Our upsells are primarily derived by an increase in the number of seat licenses purchased by our customers, but are also derived from the addition of other subscription services.

Renewal rate. We calculate our renewal rate by subtracting our attrition rate from 100%. Our attrition rate for a period is equal to the annual contract value from lost customers, divided by the total annual contract value from all customers that renewed

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during the period and from all lost customers. A lost customer is a customer that did not renew a contract expiring in the period and that, in our judgment, will not renew. Annual contract value is equal to the first twelve months of expected subscription revenues under a contract. Typically a customer that reduces its subscription upon renewal is not considered a lost customer. Rather, these decreases in annual contract value are netted against upsells. However, in instances where the subscription decrease represents the majority of the customer's annual contract value, we may deem the renewal as a lost customer. We believe our renewal rate is an important metric to measure the long-term value of customer agreements and our ability to retain our customers. Our renewal rate was 97% and 96% for the three months ended September 30, 2013 and 2012, respectively, and 96% for both the nine months ended September 30, 2013 and 2012.

Investment in growth. We have invested, and intend to continue to invest in, expanding our operations, including increasing our headcount, expanding our cloud-based infrastructure and developing technology to support our growth. We have recently, and may in the future, also enter into acquisition transactions. We expect our total operating expenses to increase in the foreseeable future in terms of dollars, however decline as a percent of total revenues.

Professional services model. We believe our professional services engagements by us or our partners facilitate the adoption of our subscription service. Beginning in December 2011, we began shifting our pricing model from a fixed-fee basis to a time-and-materials basis and improving the process by which we scope projects and manage resource utilization.

Expansion beyond IT. Our customers can purchase access to our application suite for use outside of the IT department. Customers may also purchase access to our services to develop custom applications. Although in the near term we expect our revenue growth to be primarily driven by adoption and penetration of our suite of applications for use within IT, we continue to enhance the development capabilities within the platform, allowing custom application development to expand within our customer base. We believe the extensibility and simplicity of our platform is resulting in an increased use of our application suite outside of the IT department as well as an increase in custom application development.

Components of Results of Operations

Revenues

Subscription revenues. Subscription revenues are primarily comprised of fees that give customers access to the ordered subscription service and related support and includes updates of the subscribed service during the subscription term. Pricing includes multiple instances, hosting and support services, data backup and disaster recovery services, as well as future upgrades offered during the subscription period. In addition, we offer three separately priced enabling technologies, Discovery, Orchestration and Performance Analytics. We typically invoice our customers for subscription fees in annual increments upon execution of the initial contract or subsequent renewal. Our average initial contract term was approximately 35 months and 33 months for the three and nine months ended September 30, 2013 and 31 months and 33 months for the three and nine months ended September 30, 2012. Our contracts are generally non-cancelable, though customers can terminate for breach if we materially fail to perform.

We generate sales directly through our sales team and, to a lesser extent, through our channel partners. Sales to our channel partners are made at a discount and revenues are recorded at the discounted price when all revenue recognition criteria are met. From time to time, our channel partners also provide us referrals for which we pay a referral fee. We pay referral fees to channel partners and other third parties typically ranging from 2% to 34% of the first year’s annual contract value. These fees are included in sales and marketing expense.

Professional services and other revenues. Professional services revenues consist of fees associated with the implementation and configuration of our subscription service. Other revenues include customer training and attendance and sponsorship fees for Knowledge, our annual user conference. Prior to 2012, our pricing for professional services was predominantly on a fixed-fee basis. Beginning in December 2011, we began shifting our pricing model to a time-and-materials basis. In 2013, the majority of our new business has been priced on a time-and-materials basis, a trend we expect to continue. In the three and nine months ended September 30, 2012, the average professional services engagement was four months and five months, respectively. The average professional services engagement completed during the three and nine months ended September 30, 2013 was five months. We invoice a majority of our fixed price professional services contracts upon execution of the contract. Our time-and-materials professional services are generally billed monthly in arrears based on actual hours and expenses incurred. Typical payment terms provide our customers pay us within 30 days of invoice.

Refer to “Critical Accounting Policies and Significant Judgments and Estimates” below for further discussion of our revenue recognition accounting policy.

Overhead Allocation

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Overhead associated with benefits, facilities and IT costs is allocated to cost of revenues and operating expenses based on headcount.

Cost of Revenues

Subscription cost of revenues. Cost of subscription revenues consists primarily of expenses related to hosting our service and providing support to our customers. These expenses are comprised of data center capacity costs; personnel and related costs directly associated with our cloud-based infrastructure and customer support, including salaries, benefits, bonuses and stock-based compensation; and allocated overhead.

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

Professional services associated with the implementation and configuration of our subscription services are performed directly by our services team, as well as by contracted third-party vendors. Fees paid up-front to our third-party vendors are deferred and amortized to cost of revenues as the professional services are delivered. Fees owed to our third-party vendors are accrued over the same requisite service period. Internal payroll costs are similarly recognized as professional services are delivered. Cost of revenues associated with our professional services engagements contracted with third-party vendors was $3.5 million and $1.4 million in the three months ended September 30, 2013 and 2012, respectively, and $9.1 million and $7.4 million in the nine months ended September 30, 2013 and 2012, respectively.

Sales and Marketing Expenses

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

Research and Development Expenses

Research and development expenses consist primarily of personnel and related expenses directly associated with our research and development staff, including salaries, benefits, bonuses and stock-based compensation, and allocated overhead.

General and Administrative Expenses

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

Provision for Income Taxes

Provision for income taxes consists of federal, state and foreign income taxes. Due to cumulative losses, we maintain a valuation allowance against our deferred tax assets as of September 30, 2013. We consider all available evidence,

both positive and negative, in assessing the extent to which a valuation allowance should be applied against our deferred tax assets.

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Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Revenues:				
Subscription	$92,992	$55,279	$244,926	$141,640
Professional services and other	18,267	9,066	54,494	26,910
Total revenues	111,259	64,345	299,420	168,550
Cost of revenues[(1)]:				
Subscription	23,429	17,931	61,960	43,182
Professional services and other	18,146	9,643	47,921	28,519
Total cost of revenues	41,575	27,574	109,881	71,701
Gross profit	69,684	36,771	189,539	96,849
Operating expenses[(1)]:				
Sales and marketing	47,336	28,140	137,853	74,356
Research and development	20,819	10,783	54,809	26,098
General and administrative	16,179	11,195	43,783	24,441
Total operating expenses	84,334	50,118	236,445	124,895
Loss from operations	(14,650)	(13,347)	(46,906)	(28,046)
Interest and other income (expense), net	600	615	(604)	1,148
Loss before provision for income taxes	(14,050)	(12,732)	(47,510)	(26,898)
Provision for income taxes	663	321	1,966	519
Net loss	$(14,713)	$(13,053)	$(49,476)	$(27,417)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Cost of revenues:				
Subscription	$2,190	$1,276	$5,980	$2,514
Professional services and other	1,209	495	3,095	964
Sales and marketing	5,945	2,899	14,752	6,852
Research and development	4,176	1,919	11,005	4,121
General and administrative	4,331	1,624	9,893	4,137

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues:				
Subscription	84%	86%	82%	84%
Professional services and other	16	14	18	16
Total revenues	100	100	100	100
Cost of revenues:				
Subscription	21	28	21	26
Professional services and other	16	15	16	17
Total cost of revenues	37	43	37	43
Gross profit	63	57	63	57
Operating expenses:				
Sales and marketing	43	44	46	44
Research and development	19	17	18	15
General and administrative	15	17	15	15
Total operating expenses	77	78	79	74
Loss from operations	(14)	(21)	(16)	(17)
Interest and other income, net	1	1	—	1
Loss before provision for income taxes	(13)	(20)	(16)	(16)
Provision for income taxes	—	—	1	—
Net loss	(13)%	(20)%	(17)%	(16)%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Revenues by geography				
North America	$76,851	$45,509	$208,851	$120,124
EMEA [1]	27,621	16,133	72,403	42,027
Asia Pacific and other	6,787	2,703	18,166	6,399
Total revenues	$111,259	$64,345	$299,420	$168,550

(1) Europe, the Middle East and Africa, or EMEA

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues by geography				
North America	69%	71%	70%	71%
EMEA	25	25	24	25
Asia Pacific and other	6	4	6	4
Total revenues	100%	100%	100%	100%

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Comparison of the three months ended September 30, 2013 and 2012

Revenues

	Three Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Revenues:				
Subscription	$92,992	$55,279	68	%
Professional services and other	18,267	9,066	101	%
Total revenues	$111,259	$64,345	73	%
Percentage of revenues:				
Subscription	84 %	86 %		
Professional services and other	16	14		
Total	100 %	100 %		

Revenues increased $46.9 million during the three months ended September 30, 2013 compared to the same period in the prior year, primarily due to an increase in subscription revenues of $37.7 million driven by an increase in our customer count, additional sales from existing customers, or upsells, and renewals. Total customer count at September 30, 2013 was 1,900 compared to 1,346 at September 30, 2012, an increase of 554 customers, or 41%. Our upsell rate and renewal rate for the trailing twelve months ending September 30, 2013 were 30% and 96%, respectively compared to 29% and 96%, respectively for the trailing twelve months ending September 30, 2012.

Professional services and other revenues increased $9.2 million during the three months ended September 30, 2013 compared to the same period in the prior year due to an increase in services provided to our growing customer base, increase in billable utilization and improvements in pricing of our professional services engagements.

Our average total revenue per customer, defined as trailing four quarters' revenues divided by the average number of customers during the trailing four quarters, increased to approximately $219,000 for the three months ended September 30, 2013 compared to approximately $181,000 for the three months ended September 30, 2012.

Cost of Revenues and Gross Profit Percentage

	Three Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Cost of revenues:				
Subscription	$23,429	$17,931	31	%
Professional services and other	18,146	9,643	88	%
Total cost of revenues	$41,575	$27,574	51	%
Gross profit percentage:				
Subscription	75 %	68 %		
Professional services and other	1 %	(6)%		
Total gross profit percentage	63 %	57 %		
Headcount (at period end)				
Subscription	299	202	48	%
Professional services and other	278	159	75	%
Total headcount	577	361	60	%

Cost of subscription revenues increased $5.5 million during the three months ended September 30, 2013 compared to the same period in the prior year, primarily due to increased personnel-related expenses within our cloud-based infrastructure and support organizations and additional investments in our data centers, offset by a decrease in third party hosting expenses. Personnel-

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related expenses were $13.3 million during the three months ended September 30, 2013 compared to $8.5 million during the three months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $3.9 million and additional stock-based compensation of $0.9 million.

On December 31, 2012, we completed our migration from the managed services data centers to co-location data centers which decreased our third party hosting expenses by $0.5 million during the three months ended September 30, 2013. Depreciation expense related to our cloud-based infrastructure hardware increased $1.1 million primarily due to purchases of equipment in our co-location data centers partially offset by a decrease in depreciation expense associated with the termination of our managed service data centers.
Our subscription gross profit percentage was 75% for the three months ended September 30, 2013 compared to 68% for the three months ended September 30, 2012. We expect our subscription gross profit percentage to decline slightly for the remainder of the year, as we continue to invest in our cloud-based infrastructure and support personnel, grow our data center footprint and purchase new equipment to support our growing customer base.

Cost of professional services and other revenues increased $8.5 million during the three months ended September 30, 2013 as compared to the prior year, primarily due to increased personnel-related expenses. Personnel-related expenses were $12.6 million during the three months ended September 30, 2013 compared to $7.1 million during the three months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $4.7 million and additional stock-based compensation of $0.7 million, driven by headcount growth and an increase in our stock price. Outside service costs increased from $1.5 million during the three months ended September 30, 2012 to $3.6 million during the three months ended September 30, 2013 primarily due to growth in professional services and a corresponding growth in work sub-contracted to our partners.

Our professional services and other gross profit percentage improved to 1% during the three months ended September 30, 2013 compared to (6)% during the three months ended September 30, 2012 due to improvements in scoping and pricing projects and resource utilization. Due to the anticipated increase in headcount in the professional services organization for the remainder of the year, we expect our gross profit percentage from professional services and other to remain relatively flat.

Sales and Marketing

	Three Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Sales and marketing	$47,336	$28,140	68	%
Percentage of revenues	43 %	44 %		
Headcount (at period end)	581	330	76	%

Sales and marketing expenses increased $19.2 million during the three months ended September 30, 2013 compared to the same period in the prior year, primarily driven by the expansion of our direct sales team and increases in marketing program expenses to address additional opportunities in new and existing markets. Excluding commissions, personnel-related expenses were $32.7 million during the three months ended September 30, 2013 compared to $18.6 million during the three months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $11.0 million and additional stock-based compensation of $3.0 million. Overhead expenses increased $1.1 million due to increased headcount. Commissions increased $4.6 million primarily due to growth in bookings in prior periods and current year changes made to our commission plans. Commissions and referral fees were 10% and 9% of subscription revenues for the three months ended September 30, 2013 and 2012, respectively.

Marketing program expenses, which include events, advertising and market data, increased $0.9 million during the three months ended September 30, 2013 compared to the same period in the prior year. We expect sales and marketing expenses to increase for the remainder of the year in terms of dollars and remain relatively flat as a percentage of total revenues as we continue to expand our direct sales force, increase our marketing activities, grow our international operations, build brand awareness and sponsor additional marketing events.

Research and Development

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	Three Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Research and development	$20,819	$10,783	93	%
Percentage of revenues	19 %	17 %		
Headcount (at period end)	296	164	80	%

Research and development expenses increased $10.0 million during the three months ended September 30, 2013 compared to the same period in the prior year, driven by our continued investments in upgrading and extending our service offerings and the development of new technologies. Personnel-related expenses were $17.8 million during the three months ended September 30, 2013 compared to $9.7 million during the three months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $5.8 million and additional stock-based compensation of $2.3 million. Outside services increased $1.0 million primarily due to the increase in consultants used for product releases.

We expect research and development expenses to increase in terms of dollars, however remain relatively flat as a percent of total revenues for the remainder of the year as we continue to improve the existing functionality of our service, develop new applications to fill market needs and continue to enhance our core platform.

General and Administrative

	Three Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
General and administrative	$16,179	$11,195	45	%
Percentage of revenues	15 %	17 %		
Headcount (at period end)	200	108	85	%

General and administrative expenses increased $5.0 million during the three months ended September 30, 2013 compared to the same period in the prior year, primarily due to increased headcount and our international expansion, partially offset by a decrease in corporate expenses. Personnel-related expenses were $12.0 million during the three months ended September 30, 2013 compared to $5.5 million during the three months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $3.8 million and additional stock-based compensation of $2.7 million, as we added employees to support the growth of our business. Corporate expenses decreased by $2.2 million primarily due to the relocation of our San Diego, California office, for which we incurred $2.9 million in lease abandonment costs during the three months ended September 30, 2012.

We expect general and administrative expenses to increase in terms of dollars, however remain relatively flat as a percent of total revenues for the remainder of the year as we continue to grow. These expenses include higher legal, corporate insurance and accounting expenses, and the additional expenses of achieving and maintaining compliance with Section 404 of the Sarbanes-Oxley Act and related regulations.

Interest and Other Income (Expense), net

	Three Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Interest and other income (expense), net	$600	$615	(2	)%
Percentage of revenues	1 %	1 %		

Interest and other income (expense), net, for the three months ended September 30, 2013 did not change significantly in total or by expense category compared to the same period in the prior year.

Provision for Income Taxes

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	Three Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Loss before income taxes	$(14,050)	$(12,732)	10	%
Provision for income taxes	663	321	107	%
Effective tax rate	(5)%	(3)%		

Our effective tax rate changed to (5)% for the three months ended September 30, 2013 from (3)% for the three months ended September 30, 2012, due to a higher proportion of earnings in jurisdictions with higher statutory tax rates, a higher loss from U.S. operations, and the tax effect of integration of acquired companies for the three months ended September 30, 2013 compared to the same period in the prior year.

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

Comparison of the nine months ended September 30, 2013 and 2012

Revenues

	Nine Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Revenues:				
Subscription	$244,926	$141,640	73	%
Professional services and other	54,494	26,910	103	%
Total revenues	$299,420	$168,550	78	%
Percentage of revenues:				
Subscription	82%	84%		
Professional services and other	18	16		
Total	100%	100%		

Revenues increased $130.9 million during the nine months ended September 30, 2013 compared to the same period in the prior year, primarily due to an increase in subscription revenues of $103.3 million driven by an increase in our customer count, additional sales from existing customers, or upsells, and renewals.

Professional services and other revenues increased $27.6 million during the nine months ended September 30, 2013 compared to the same period in the prior year. The increase was primarily due to a $21.8 million increase in professional services revenues which resulted from an increase in services provided to our growing customer base, increase in billable utilization and improvements in pricing of our professional services engagements. In addition, revenues from our Knowledge user conference held once a year in the second quarter increased to $5.0 million during the nine months ended September 30, 2013 compared to $2.0 million in the same period in the prior year due to increased sponsorship and paid registration.

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Cost of Revenues and Gross Profit Percentage

	Nine Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Cost of revenues:				
Subscription	$61,960	$43,182	43	%
Professional services and other	47,921	28,519	68	%
Total cost of revenues	$109,881	$71,701	53	%
Gross profit percentage:				
Subscription	75 %	70 %		
Professional services and other	12 %	(6)%		
Total gross profit percentage	63 %	57 %		
Headcount (at period end)				
Subscription	299	202	48	%
Professional services and other	278	159	75	%
Total headcount	577	361	60	%

Cost of subscription revenues increased $18.8 million during the nine months ended September 30, 2013 compared to the same period in the prior year, primarily due to increased personnel-related expenses within our cloud-based infrastructure and support organizations and additional investments in our data centers, offset by a decrease in third party hosting expenses. Personnel-related expenses were $35.7 million during the nine months ended September 30, 2013 compared to $21.3 million during the nine months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $11.0 million and additional stock-based compensation of $3.5 million. Overhead expenses increased $2.0 million.

On December 31, 2012, we completed our migration from the managed services data centers to co-location data centers which decreased our third party hosting expenses by $1.1 million. Depreciation expense related to our cloud-based infrastructure hardware increased $3.8 million primarily due to purchases of equipment in our co-location data centers partially offset by a decrease in depreciation expense associated with our managed service data centers.
Cost of professional services and other revenues increased $19.4 million during the nine months ended September 30, 2013 compared to the same period in the prior year, primarily due to increased personnel-related expenses. Personnel-related expenses were $33.6 million during the nine months ended September 30, 2013 compared to $18.5 million during the nine months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $12.9 million and additional stock-based compensation of $2.1 million, driven by headcount growth and an increase in our stock price. Overhead expenses increased $1.4 million. Outside service costs increased $1.8 million primarily due to growth in professional services and corresponding growth in work sub-contracted to our partners.
Our professional services and other gross profit (loss) percentage increased to 12% during the nine months ended September 30, 2013 compared to (6)% in the same period in the prior year due to improved scoping and pricing on customer engagements and better resource utilization. In addition, revenues from our Knowledge user conference increased from $2.0 million to $5.0 million during the nine months ended September 30, 2013 with all related expenses recorded in sales and marketing compared to the same period in the prior year. The conference contributed 9 percentage points to other gross profit percentage for the nine months ended September 30, 2013 and 2012.

Sales and Marketing

	Nine Months Ended September 30,		% Change

	2013		2012			
	(dollars in thousands)					
Sales and marketing	$137,853		$74,356		85	%
Percentage of revenues	46	%	44	%		
Headcount (at period end)	581		330		76	%

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Sales and marketing expenses increased $63.5 million during the nine months ended September 30, 2013 compared to the same period in the prior year, primarily driven by the expansion of our direct sales team, our annual Knowledge user conference and increases in marketing program expenses to address additional opportunities in new and existing markets. Excluding commissions, personnel-related expenses were $89.2 million during the nine months ended September 30, 2013 compared to $50.2 million during the nine months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $30.8 million and additional stock-based compensation of $7.9 million. Overhead expenses also increased $3.4 million. Commissions increased $11.9 million primarily due to growth in bookings in prior periods and current year changes made to our commission plans. Commissions and referral fees were 10% and 8% of subscription revenues for the nine months ended September 30, 2013 and 2012, respectively.

In addition, expenses related to our Knowledge user conference increased to $8.3 million for the nine months ended September 30, 2013 from $4.7 million in the same period in the prior year due to attendance more than doubling year-over-year. All other marketing program expenses, which include events, advertising and market data, increased $2.7 million. Outside services increased $1.1 million primarily due to the increase in contractor expenses related to our growth in foreign countries.

Research and Development

	Nine Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
Research and development	$54,809	$26,098	110	%
Percentage of revenues	18 %	15 %		
Headcount (at period end)	296	164	80	%

Research and development expenses increased $28.7 million during the nine months ended September 30, 2013 compared to the same period in the prior year, driven by our continued investments in upgrading and extending our service offerings and the development of new technologies. Personnel-related expenses were $48.0 million during the nine months ended September 30, 2013 compared to $23.7 million during the nine months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $17.5 million and additional stock-based compensation of $6.9 million. Overhead expenses also increased $2.1 million. Outside services increased $1.4 million primarily due to the increase in consultants used for product releases.

General and Administrative

	Nine Months Ended September 30,		% Change	
	2013	2012		
	(dollars in thousands)			
General and administrative	$43,783	$24,441	79	%
Percentage of revenues	15 %	15 %		
Headcount (at period end)	200	108	85	%

General and administrative expenses increased $19.3 million during the nine months ended September 30, 2013 compared to the same period in the prior year, primarily due to increased headcount, corporate expenses and our international expansion. Personnel-related expenses were $29.7 million during the nine months ended September 30, 2013 compared to $14.2 million during the nine months ended September 30, 2012, consisting primarily of increased employee compensation, benefits, travel and hiring expenses of $9.7 million and additional stock-based compensation

of $5.8 million, as we added employees to support the growth of our business. Overhead and corporate expenses increased $1.3 million and $1.9 million, respectively, primarily due to headcount growth. Included in corporate expenses are $0.6 million in transaction costs incurred in the nine months ended September 30, 2013 related to the Mirror42 acquisition, which closed on July 1, 2013.

Interest and Other Income (Expense), net

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	Nine Months Ended September 30,		% Change
	2013	2012	
	(dollars in thousands)		
Interest and other income (expense), net	$(604)	$1,148	(153)%
Percentage of revenues	— %	1 %	

Interest and other income (expense), net decreased $1.8 million during the nine months ended September 30, 2013 compared to the same period in the prior year. Foreign currency transaction gain and loss decreased to an expense of $1.4 million for the nine months ended September 30, 2013, compared to an income of $0.9 million in the same period in the prior year. The decrease was primarily due to the weakening of the U.S. dollar compared to the same period in the prior year, partially offset by a $0.4 million increase in interest income due to the increased cash balance at September 30, 2013 compared to the same period in the prior year.

Provision for Income Taxes

	Nine Months Ended September 30,		% Change
	2013	2012	
	(dollars in thousands)		
Loss before income taxes	$(47,510)	$(26,898)	77 %
Provision for income taxes	1,966	519	279 %
Effective tax rate	(4)%	(2)%	

Our effective tax rate changed to (4)% during the nine months ended September 30, 2013 from (2)% during the nine months ended September 30, 2012, due to a higher proportion of earnings in jurisdictions with higher statutory tax rates, a higher loss from U.S. operations, and the tax effect of integration of acquired companies for the nine months ended September 30, 2013 compared to the same period in the prior year.

Liquidity and Capital Resources

	Nine Months Ended September 30,	
	2013	2012
	(dollars in thousands)	
Net cash provided by operating activities	$45,479	$32,095
Net cash used in investing activities	(93,148)	(172,245)
Net cash provided by financing activities	48,952	189,593
Net increase in cash and cash equivalents, net of impact of exchange rates on cash	2,105	48,888

At September 30, 2013, we had $121.1 million in cash and cash equivalents, of which $26.9 million represented cash located outside the United States. We also had $231.7 million in investments consisting of commercial paper and corporate debt securities.

Based on our current level of operations and anticipated growth, we believe our current cash, cash equivalents and investments, and cash flows from operating activities will be sufficient to fund our operating needs for at least the next 12 months, barring unforeseen circumstances.

Operating Activities

Net cash provided by operating activities for the nine months ended September 30, 2013 was $45.5 million, reflecting our net loss of $49.5 million, adjusted by non-cash charges including $44.7 million for stock-based compensation

expense, $19.8 million for amortization of deferred commissions, $16.3 million for depreciation and amortization, $3.4 million for amortization of premiums on investments, $0.4 million for lease abandonment costs, and non-cash benefits including $1.8 million tax benefit from exercise of stock options and changes in our operating assets and liabilities. Our overall net change in operating assets and liabilities was $11.2 million and primarily comprised of a $54.3 million increase in deferred revenue, a $2.8 million decrease in prepaid expenses and other assets and a $2.6 million decrease in accrued expenses and other current liabilities, offset by a $7.0 million increase in accounts receivable, a $34.9 million increase in deferred commissions and a $1.8 million increase in other assets. The increases in deferred revenue, deferred commissions and accounts receivable were primarily due to increased sales

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for the nine months ended September 30, 2013. The decrease in prepaid expenses and other current assets and accrued expenses and other current liabilities is primarily due to the timing of cash settlement during the nine months ended September 30, 2013 related to income tax withholdings from stock options exercised in December 2012. The increase in other assets is due to intellectual property acquired in the Mirror42 acquisition, which closed in July 2013.

Net cash provided by operating activities in the nine months ended September 30, 2012 was $32.1 million reflecting our net loss of $27.4 million, adjusted by non-cash charges including $18.6 million for stock-based compensation, $9.3 million for the amortization of deferred commissions, $8.8 million for depreciation and amortization, $2.9 million for lease abandonment costs, and changes in our working capital. The fluctuations in our working capital were primarily attributed to increases of $43.1 million in deferred revenue, $4.6 million in accrued liabilities and $2.4 million in other long-term liabilities and a decrease of $4.2 million in prepaid expenses and other current assets, partially offset by an $11.1 million increase in accounts receivable, a $20.5 million increase in deferred commissions and a $3.0 million decrease in deferred rent. The increases in deferred revenue, deferred commissions and accounts receivable were primarily due to increased sales in the nine months ended September 30, 2012. The increase in accrued liabilities is due to the growth of our business and the corresponding 60% increase in our headcount during the nine months ended September 30, 2012. The decrease in prepaid expenses and other current assets was primarily due to the settlement of the founder’s outstanding receivable for withholding taxes associated with the sale of Series C and Series D preferred stock. The decrease in deferred rent is offset by the increase in other long-term liabilities related to the relocation of our San Diego office to another facility in San Diego, California in August 2012.

Investing Activities

For the nine months ended September 30, 2013, cash used in investing activities was primarily attributed to cash paid for capital expenditures of $39.1 million primarily related to the purchase of cloud-based infrastructure hardware to support the expansion of our data centers as well as investments in leasehold improvements and furniture and equipment to support our headcount growth. The purchase of $233.4 million in investments was offset by proceeds from maturities of $142.5 million and sale of investments of $50.4 million.

For the nine months ended September 30, 2012, cash used in investing activities was primarily attributable to the purchase of $146.9 million in investments, offset by proceeds from maturities of $5.8 million and cash paid for capital expenditures of $32.2 million primarily related to the purchase of cloud-based infrastructure hardware to support the expansion of our data centers.

Financing Activities

Our financing activities have primarily consisted of equity issuances, including excess tax benefits from stock award activities.

For the nine months ended September 30, 2013, cash provided by financing activities primarily consisted of proceeds from the exercise of employee stock options and related excess tax benefits and issuance of common stock from employee stock plans.

For the nine months ended September 30, 2012, cash provided by financing activities primarily consisted of initial public offering proceeds of $169.8 million, net of paid underwriter discounts and commissions and issuance costs, $17.9 million in gross proceeds from the issuance of 1,750,980 shares of common stock at a price of $10.20 per share through a private placement with a new stockholder and $3.4 million in proceeds from the issuance of common stock through the exercise of employee stock options. These increases in cash were slightly offset by purchases of common stock and restricted stock from stockholders of $2.0 million.

Contractual Obligations and Commitments

Contractual obligations represent future cash commitments and liabilities under agreements with third parties, and exclude orders for goods and services entered into in the normal course of business that are not enforceable or legally binding.

The following table represents our known contractual obligations as of September 30, 2013, aggregated by type:

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Contractual Obligations	Payments Due by Period				
	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
	(in thousands)				
Operating leases:					
Data centers[1]	$20,607	$11,792	$8,653	$162	$—
Facilities space[2]	105,268	8,809	39,540	23,960	32,959
Total operating leases	$125,875	$20,601	$48,193	$24,122	$32,959

(1) Operating leases for data centers represent our principal commitment for data center facilities and bandwidth.
(2) Operating leases for facilities space represents our principal commitments for office space. Lease commitments of $8.8 million related to the lease for our former San Diego office, which we vacated in 2012, are also included in the table above.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Significant Judgments and Estimates

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

While our significant accounting policies are more fully described in Note 2 to our consolidated financial statements, we believe that the following accounting policies are critical to the process of making significant judgments and estimates in the preparation of our audited consolidated financial statements.

Revenue Recognition

We commence revenue recognition when all of the following conditions are met:

- There is persuasive evidence of an arrangement;
- The service has been provided to the customer;
- The collection of related fees is reasonably assured; and
- The amount of fees to be paid by the customer is fixed or determinable.

We use a signed contract together with either a signed order form or a purchase order, as evidence of an arrangement for a new customer. In subsequent transactions with an existing customer, including an upsell or a renewal, we consider the existing signed contract and either the new signed order form or new purchase order as evidence of an arrangement.

We recognize subscription revenues ratably over the contract term beginning on the commencement date of each contract, which is the date we make our service available to our customers. Once our service is available to customers, we record amounts due in accounts receivable and in deferred revenue. We price our professional services primarily on a time-and-materials basis. We recognize professional services and other revenues as the services are delivered using a proportional performance model. Such services are delivered over a short period of time. In instances where final acceptance of the services are required before revenues are recognized, we defer professional services revenues and the associated costs until all acceptance criteria have been met.

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We assess collectibility based on a number of factors such as past collection history with the customer and creditworthiness of the customer. If we determine collectibility is not reasonably assured, we defer revenue recognition until collectibility becomes reasonably assured. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. Our arrangements do not include general rights of return.

We have multiple element arrangements comprised of subscription fees and professional services. We account for subscription and professional services revenues as separate units of accounting. To qualify as a separate unit of accounting, the delivered item must have value to the customer on a standalone basis. We have concluded that our subscription service has standalone value as it is routinely sold separately by us. In addition, the applications offered through this subscription service are fully functional without any additional development, modification or customization. We provide customers access to our subscription service at the beginning of the contract term. In determining whether professional services have standalone value, we considered the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date and the contractual dependence of the subscription service on the customer's satisfaction with the professional services work. Our professional services, including implementation and configuration services, are not so unique and complex that other vendors cannot provide them. In some instances, customers independently contract with third-party vendors to do the implementation and we regularly outsource implementation services to contracted third-party vendors. As a result, we concluded professional services, including implementation and configuration services, have standalone value.

We determine the selling price of each deliverable in the arrangement using the selling price hierarchy. Under the selling price hierarchy, the selling price for each deliverable is determined using vendor-specific objective evidence, or VSOE, of selling price or third-party evidence, or TPE, of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, the selling price is determined using the best estimate of selling price, or BESP. The selling price for each unit of account is based on the BESP since VSOE and TPE are not available for our subscription service or professional services and other. The BESP for each deliverable is determined primarily by considering the historical selling price of these deliverables in similar transactions as well as other factors, including, but not limited to, market competition, review of stand-alone sales and current pricing practices. In determining the appropriate pricing structure, we consider the extent of competitive pricing of similar products and marketing analyses. The total arrangement fee for these multiple element arrangements is then allocated to the separate units of account based on the relative selling price. We price our subscription service using a scaled model based on the duration of the subscription term and we frequently extend discounts to our customers based on the number of users.

In limited circumstances, we grant certain customers the right to deploy our subscription service on the customers’ own servers without significant penalty. We have analyzed all of the elements in these particular multiple element arrangements and determined we do not have sufficient VSOE of fair value to allocate revenue to our subscription service and professional services. We defer all revenue under the arrangement until the last element in the transaction has been delivered or started to be delivered. Once the subscription service and the associated professional services have commenced, the entire fee from the arrangement is recognized ratably over the remaining period of the arrangement.

Deferred Commissions

We defer the majority of expenses associated with commission payments made to our direct sales force and referral fees paid to independent third-parties. The majority of commissions and referral fees that are deferred are amortized to sales expense over the non-cancelable terms of the related contracts with our customers. The commission payments are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable

through the future revenue streams under the non-cancelable customer contracts. We believe this is preferable to expensing sales commissions as incurred because the commission charges are so closely related to revenues they should be recorded as an asset and charged to expense over the same period the revenues are recognized. Additionally, we believe this policy election enhances the comparability of our consolidated financial statements to those of other companies in our industry.

Stock-Based Compensation

We measure compensation expense for all stock-based payments made to employees and directors based on the fair value of the award as of the date of grant. The expense is recognized, net of estimated forfeitures, over the requisite service period, which is generally the vesting period of the respective award. We estimate forfeitures based upon our historical experience. We use the Black-Scholes option-pricing model to determine the fair value of our stock options and employee stock purchase plan, or ESPP, awards. For restricted stock units, the fair value of the award is determined based on the fair value of our common stock on the grant date.

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Determining the fair value under the Black-Scholes model requires the use of inputs that are subjective and generally require significant analysis and judgment to develop. These inputs include the fair value of our common stock, expected volatility, expected term, risk-free interest rate, and expected dividend yield, which are estimated as follows:

- Fair value of our common stock: Because our stock was not publicly traded prior to our initial public offering, we estimated the fair value of our common stock in accordance with the guidelines outlined in the American Institute of Certified Public Accountants Practice Aid, Valuation of Privately-Held-Company Equity Securities Issued as Compensation. Following our initial public offering in June 2012, our common stock was valued by reference to its publicly traded price.
- Expected volatility: We use the historic volatility of publicly traded peer companies as an estimate for our expected volatility. In considering peer companies, we assess characteristics such as industry, stage of development, size, and financial leverage. We intend to continue to consistently apply this process using the same or similar public companies until a sufficient amount of historical information regarding the volatility of our own common stock share price becomes available.
- Expected term: We estimate the expected term using the simplified method due to the lack of historical exercise activity for our company. The simplified method calculates the expected term as the mid-point between the vesting date and the contractual expiration date of the award.
- Risk-free interest rate: The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the stock-based award.
- Dividend yield: Our expected dividend yield is zero, as we have not and do not currently intend to declare dividends in the foreseeable future.

If any assumptions used in the Black-Scholes model change significantly, stock-based compensation for future awards may differ materially compared with the awards granted previously.

Income Taxes

Our provision for income taxes, deferred tax assets and liabilities, and reserves for unrecognized tax benefits reflect our best assessment of estimated future taxes to be paid. Significant judgments and estimates based on interpretations of existing tax laws or regulations in the United States and the numerous foreign jurisdictions where we are subject to income tax are required in determining our provision for income taxes. Changes in tax laws, statutory tax rates, and estimates of our future taxable income could impact the deferred tax assets and liabilities provided for in the consolidated financial statements and would require an adjustment to the provision for income taxes.

Deferred tax assets are regularly assessed to determine the likelihood they will be recovered from future taxable income. A valuation allowance is established when we believe it is more likely than not the future realization of all or some of a deferred tax asset will not be achieved. In evaluating our ability to recover deferred tax assets within the jurisdiction in which they arise, we consider all available positive and negative evidence. Factors reviewed include the cumulative pre-tax book income for the past three years, scheduled reversals of deferred tax liabilities, our history of earnings and reliable forecasting, projections of pre-tax book income over the foreseeable future, and the impact of any feasible and prudent tax planning strategies.

We recognize the impact of a tax position in our consolidated financial statements only if that position is more likely than not of being sustained upon examination by taxing authorities, based on the technical merits of the position. Tax authorities regularly examine our returns in the jurisdictions in which we do business and we regularly assess the tax risk of our return filing positions. Due to the complexity of some of the uncertainties, the ultimate resolution may result in payments that are materially different from our current estimate of the tax liability. These differences, as well as any interest and penalties, will be reflected in the provision for income taxes in the period in which they are determined.

Recent Accounting Pronouncements

In July 2013, the FASB issued a new accounting standard update on the financial statement presentation of unrecognized tax benefits. The new guidance provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward, if such settlement is required or expected in the event the uncertain tax position is disallowed. The new guidance becomes effective for us on January 1, 2014 and it should be applied prospectively to unrecognized tax benefits that exist at the effective date with retrospective application permitted. We are currently assessing the impacts of this new guidance.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

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There have been no material changes in our market risk during the nine months ended September 30, 2013, compared to the disclosures in Part II, Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2012.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in internal control over financial reporting

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

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PART II

ITEM 1. LEGAL PROCEEDINGS

From time to time, we may become involved in legal proceedings arising in the ordinary course of our business. We are not presently a party to any legal proceedings that, if determined adversely to us, would individually or taken together have a material adverse effect on our business, operating results, financial condition or cash flows.

ITEM 1A. RISK FACTORS

We have identified the following risks and uncertainties that may have a material adverse effect on our business, financial condition, results of operations and future prospects. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained in this Quarterly Report on Form 10-Q, including our consolidated financial statements and related notes.

Risks Related to Our Business and Industry

Defects or disruptions in our service could diminish demand for our service, harm our financial results and subject us to substantial liability.

Our customers use our service to manage important aspects of their businesses, and any errors, defects, disruptions to our service or other performance problems with our service could hurt our reputation and may damage our customers' businesses. From time to time, we have found defects in our service, and new errors in our existing service may be detected in the future. For example, recently a few of our largest customers experienced reduced levels of availability, performance and functionality due to the scale at which they had implemented our service. We cannot be sure that we will not experience similar or other issues at even larger scales in the future. We provide regular product updates, which frequently contain undetected errors when first introduced or released. Defects may also be introduced by our use of third-party software, including open-source software. Defects can be hard to detect and may result in disruptions to our service. In addition, our customers may use our service in ways that cause disruptions in service for other customers. In some of these instances, customers have delayed, and may in the future delay payment to us, may elect not to renew, and may make service credit claims, warranty claims or other claims against us. Such instances may also adversely impact our future sales. Further, if we do not meet the stated service level commitments we have guaranteed to our customers or suffer extended periods of unavailability for our service, we have provided and in the future may be contractually obligated to provide these customers with credits for future service. The occurrence of payment delays, service credit, warranty or other claims against us could result in an increase in our bad debt expense, an increase in collection cycles for accounts receivable, an increase to our warranty provisions or service level credit accruals or other increased expenses or risks of litigation. We do not carry insurance sufficient to compensate us for the potentially significant losses that may result from claims arising from defects or disruptions in our service or the potential harm to the future growth of our business due to defects or disruptions.

We have experienced rapid growth in recent periods. If we are not able to manage this growth and expansion, or if our business does not grow as we expect, our operating results may suffer.

We continue to experience rapid growth in our customer base and have significantly expanded our operations during the last several years. In particular, we are aggressively investing in: significant expansion of our cloud-based infrastructure and associated service capacity; our global sales, marketing and operations activities and personnel; and additional office facility lease commitments and administrative employees. Our employee headcount has increased to 1,654 as of September 30, 2013 from 963 as of September 30, 2012. We signed new leases for a larger corporate

office in San Diego in February 2012, additional office space in Amsterdam in September 2012, in Santa Clara in November 2012 and in London in December 2012. In addition, we hired new senior management in 2011 and 2012. Our rapid growth has placed, and will continue to place, a significant strain on our administrative and operational infrastructure facilities and other resources. Our ability to manage our operations and growth will require us to continue to expand our sales force, facilities, infrastructure and operations, and refine our operational, financial and management controls, human resource policies, and reporting systems and procedures. For instance, in 2012 we implemented a new financial enterprise resource planning system to help manage our future growth and are in the process of integrating that system with our customer relationship management system. If we fail to efficiently expand our sales force, operations, cloud-based infrastructure or IT and financial systems, or if we fail to implement or maintain effective internal controls and procedures, our costs and expenses may increase more than we plan and we may lose the ability to close customer opportunities, enhance our existing service, develop new applications, satisfy customer requirements, respond to competitive pressures or otherwise execute our business plan. Additionally, as our operating expenses increase in anticipation of the growth of our business, if such growth does not meet our expectations, our financial results likely would be harmed.

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We have a limited history of operating profits, did not generate a profit in the three and nine months ended September 30, 2013, and may not achieve or maintain profitability in the future.

We have not been consistently profitable on a quarterly or annual basis and experienced a net loss of $14.7 million and $49.5 million for the three and nine months ended September 30, 2013, respectively. As of September 30, 2013, our accumulated deficit was $155.0 million. While we have experienced significant revenue growth over recent periods, this growth rate is likely to decrease and we may not return to profitability. Over the past year, we have significantly increased our expenditures to support the development and expansion of our business, which has resulted in increased losses. We plan to continue to invest for future growth, and as a result, we do not expect to be profitable for the foreseeable future. In addition, as a public company, we will continue to incur significant accounting, legal and other expenses that we did not incur as a private company. As a result of these increased expenditures, we will have to generate and sustain increased revenues to achieve future profitability. We may incur significant losses in the future for a number of reasons, including without limitation the other risks and uncertainties described in this filing. Additionally, we may encounter unforeseen operating expenses, difficulties, complications, delays and other unknown factors that may result in losses in future periods. If these losses exceed our expectations or our revenue growth expectations are not met in future periods, our financial performance will be harmed.

We face security risks, including but not limited to theft of personal data, theft of proprietary information, denial of service attacks and other hacking attacks. If our security measures are breached or unauthorized access to customer data is otherwise obtained, our service may be perceived as not being secure, customers may curtail or stop using our service, and we may incur significant liabilities.

Our operations involve the storage and transmission of our customers' confidential information, and security breaches, computer malware and computer hacking attacks could expose us to a risk of loss of this information, litigation, indemnity obligations and other liability. For example, our third-party data center facility in London was subjected to a distributed denial of service attack in January 2012 that prevented some of our customers hosted in that data center from using our service intermittently for a period of about three hours. While we have administrative, technical, and physical security measures in place, and try to contractually require third parties to whom we transfer data to implement and maintain appropriate security measures, if our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, and, as a result, someone obtains unauthorized access to our customers' data, including personally identifiable information regarding users, our reputation will be damaged, our business may suffer and we could incur significant liability. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers' data or our data, including our intellectual property and other confidential business information, or our information technology systems. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until successfully launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose potential sales and existing customers.

We need to continue to invest in the growth of our current and future data centers to support our expected customer growth and enhance the level of service we provide to our customers. If our required investments are greater than anticipated or if our customer growth does not meet our expectations, our financial results will be negatively impacted.

We have made and will continue to make substantial investments in the growth of our current and future data centers, including capital expenditures for new cloud-based infrastructure. These investments are required to support our expected customer growth and provide enhanced levels of service to our customers. In the nine months ended September 30, 2013, we incurred $8.1 million in third party hosting expenses and purchased $23.8 million in

cloud-based infrastructure hardware for use in our data centers. Ongoing investments in our data centers and cloud-based infrastructure may be more expensive than we anticipate, may exceed what is required if our customer growth does not meet our expectations and may not yield the expected performance benefits, all of which could harm our financial results.

We may not timely and effectively scale and adapt our existing technology to meet our customers' performance and other requirements.

Our future growth is dependent upon our ability to continue to meet the needs of new customers and the expanding needs of our existing customers as their use of our service grows. As our customers gain more experience with our service, the number of users and transactions managed by our service, the amount of data transferred, processed and stored by us, the number of locations where our service is being accessed, and the number of processes and systems managed by our service on behalf of these customers have in some cases, and may in the future, expand rapidly. In the past, a few of our largest customers have experienced reduced levels of availability, performance and functionality due to the scale at which they have implemented our service. In order to meet the performance and other requirements of our customers, we intend to continue to make significant investments to develop

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and implement new technologies in our service and cloud-based infrastructure operations. These technologies, which include databases, applications and server optimizations, network and hosting strategies, and automation, are often advanced, complex, new and untested. We may not be successful in developing or implementing these technologies. In addition, it takes a significant amount of time to plan, develop and test improvements to our technologies and infrastructure, and we may not be able to accurately forecast demand or predict the results we will realize from such improvements. We are also dependent upon open source and other third-party technologies and may be unable to quickly effect changes to such technologies, which may prevent us from rapidly responding to evolving customer requirements. To the extent that we do not effectively scale our service and operations to meet the needs of our growing customer base and to maintain performance as our customers expand their use of our service, we may not be able to grow as quickly as we anticipate, our customers may reduce or cancel use of our services and we may be unable to compete as effectively and our business and operating results may be harmed.

Interruptions or delays in service from our third-party data center facilities could impair the delivery of our service and harm our business.

We currently serve our customers from third-party data center facilities, operated by several different providers, located around the world, with the largest located in Virginia, California, London and Amsterdam. Any damage to, or failure of, our systems, or those of our third-party data centers, could result in interruptions in our service. Impairment of or interruptions in our service may reduce our revenues, cause us to issue credits or pay penalties, subject us to claims and litigation, cause our customers to terminate their subscriptions and adversely affect our renewal rates and our ability to attract new customers. Our business will also be harmed if our customers and potential customers believe our service is unreliable.

We do not control, or in some cases have limited control over, the operation of the data center facilities we use, and they are vulnerable to damage or interruption from earthquakes, floods, fires, power loss and similar events. They may also be subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct, and to adverse events caused by operator error. We cannot rapidly switch to new data centers or move customers from one data center to another in the event of any adverse event. Despite precautions taken at these facilities, the occurrence of a natural disaster, an act of terrorism or other act of malfeasance, a decision to close the facilities without adequate notice or other unanticipated problems at these facilities could result in lengthy interruptions in our service and the loss of customer data.

If the market for our technology delivery model and SaaS develops more slowly than we expect, our growth may slow or stall, and our operating results would be harmed.

Use of SaaS applications to manage and automate enterprise IT is at an early stage. We do not know whether the trend of adoption of enterprise SaaS solutions we have experienced in the past will continue in the future. In particular, many organizations have invested substantial personnel and financial resources to integrate legacy software into their businesses over time, and some have been reluctant or unwilling to migrate to SaaS. Furthermore, some organizations, particularly large enterprises upon which we are dependent, have been reluctant or unwilling to use SaaS because they have concerns regarding the risks associated with the security of their data and the reliability of the technology delivery model associated with these solutions. In addition, if other SaaS providers experience security incidents, loss of customer data, disruptions in delivery or other problems, the market for SaaS solutions as a whole, including our service, will be negatively impacted. If the adoption of SaaS solutions does not continue, the market for these solutions may stop developing or may develop more slowly than we expect, either of which would harm our operating results.

The markets in which we participate are intensely competitive, and if we do not compete effectively, our operating results could be harmed.

The markets in which we compete to automate enterprise IT and provide additional solutions inside and outside IT are fragmented, rapidly evolving and highly competitive, with relatively low barriers to entry in some segments. Many of our competitors and potential competitors are larger and have greater name recognition, much longer operating histories, more established customer relationships, larger marketing budgets and significantly greater resources than we do. As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. With the introduction of new technologies, the evolution of our service and new market entrants, we expect competition to intensify in the future. If we fail to compete effectively, our business will be harmed. Some of our principal competitors offer their products or services at a lower price, which has resulted in pricing pressures. If we are unable to achieve our target pricing levels, our operating results would be negatively impacted. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses or the failure of our service to achieve or maintain more widespread market acceptance, any of which could harm our business.

We face competition from in-house solutions, large integrated systems vendors, established SaaS vendors and smaller companies with point solutions including SaaS offerings. Our competitors vary in size and in the breadth and scope of the products

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and services offered. Our primary competitors include BMC Software, Inc., CA, Inc., Hewlett-Packard Company and International Business Machines Corporation, all of which are much larger and have substantially more financial resources than we do, and have the operating flexibility to bundle competing products and services with other software offerings, including offering them at a lower price as part of a larger sale. In addition, many of our competitors offer SaaS solutions and may make acquisitions of businesses or assets that improve their service offerings. Further, other established SaaS providers not currently offering products to automate enterprise IT may expand their services to compete with our service. Many of our current and potential competitors have established marketing relationships, access to larger customer bases, pre-existing customer relationships and major distribution agreements with consultants, system integrators and resellers. In addition, some competitors may offer software that competes with a portion of our offerings at lower prices or with greater depth than our service. Moreover, as we expand the scope of our service and sell more solutions outside of IT, we may face additional competition from platform vendors such as Salesforce.com, or from application development vendors that are focused on other areas of the enterprise. Additionally, some potential customers, particularly large enterprises, may elect to develop their own internal solutions. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

Because our sales efforts are targeted at large enterprise customers, we face longer sales cycles, substantial upfront sales costs and less predictability in completing some of our sales. If our sales cycle lengthens, or if our substantial upfront sales investments do not result in sufficient sales, our operating results could be harmed.

We target our sales efforts at large enterprises, which we define as companies with over $750 million in revenues and a minimum of 200 IT employees. For instance, we derived approximately 11% of our revenues from large enterprise customers in the financial services industry for the three and nine months ended September 30, 2013. Because our large enterprise customers are often making an enterprise-wide decision to deploy our service, sometimes on a global basis, we face long sales cycles, complex customer requirements, substantial upfront sales costs and less predictability in completing some of our sales. Our sales cycle is generally six to nine months, but is variable and difficult to predict and can be much longer. Large enterprises often undertake a prolonged evaluation of our service, including whether the customer needs professional services performed by us or a third party for its unique IT and business process needs, and a comparison of our service to products offered by our competitors. Moreover, our large enterprise customers often begin to deploy our service on a limited basis, but nevertheless demand extensive configuration, integration services and pricing concessions, which increase our upfront investment in the sales effort with no guarantee that these customers will deploy our service widely enough across their organization to justify our substantial upfront investment. It is possible in the future we may experience even longer sales cycles, more complex customer needs, higher upfront sales costs and less predictability in completing some of our sales as we continue to expand our direct sales force and thereby increase the percentage of our sales personnel with less experience in selling our service, expand into new territories and expand into functional areas outside of the traditional ITIL processes. If our sales cycle lengthens or our substantial upfront sales and implementation investments do not result in sufficient sales to justify our investments, our operating results may be harmed.

Our business depends substantially on our customers renewing their subscriptions and purchasing additional subscriptions from us. Any decline in our customer renewals would harm our future operating results.

In order for us to maintain or improve our operating results, it is important that our customers renew their subscriptions when the initial contract term expires and add additional authorized users to their subscriptions. Our customers have no obligation to renew their subscriptions, and our customers may not renew subscriptions with a similar contract period or with the same or a greater number of authorized users. Although our renewal rates have been historically high, some of our customers have elected not to renew their agreements with us and we cannot accurately predict renewal rates. Moreover, in some cases, some of our customers have the right to cancel their agreements prior to the expiration of the term.

Our renewal rates may decline or fluctuate as a result of a number of factors, including our customers' satisfaction with our subscription service, professional services, customer support, or prices, the prices of competing solutions, mergers and acquisitions affecting our customer base, the effects of global economic conditions, or reductions in our customers' spending levels. Our future success also depends in part on our ability to sell more subscriptions and additional professional services to our current customers. If our customers do not renew their subscriptions, renew on less favorable terms or fail to add more authorized users or fail to purchase additional professional services, our revenues may decline, and we may not realize improved operating results from our customer base.

If we are not able to develop enhancements and new applications that achieve market acceptance or that keep pace with technological developments, our business could be harmed.

Our ability to attract new customers and increase revenues from existing customers depends in large part on our ability to enhance and improve our existing service and to introduce new services. In order to grow our business, we must develop a service that reflects future updates to the ITIL framework and extends beyond the ITIL framework into other areas of enterprise IT operations management. We are also dependent on achieving growth outside of the IT department. The success of any enhancement

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or new service depends on several factors, including timely completion, adequate quality testing, introduction and market acceptance. Any new service that we develop may not be introduced in a timely or cost-effective manner, may contain defects or may not achieve the broad market acceptance necessary to generate significant revenues. If we are unable to successfully develop new applications or enhance our existing service to meet the evolving requirements of our customers, our business and operating results will be harmed.

Because we designed our service to be provided over the Internet, we need to continuously modify and enhance our service to keep pace with changes in Internet-related hardware, software, communication, database and security technologies and standards. If we are unable to respond in a timely and cost-effective manner to these rapid technological developments and standards changes, our service may become less marketable and less competitive or obsolete and our operating results may be harmed.

If we fail to integrate our service with a variety of operating systems, software applications and hardware that are developed by others, our service may become less marketable and less competitive or obsolete, and our operating results would be harmed.

Our service must integrate with a variety of network, hardware and software platforms, and we need to continuously modify and enhance our platform to adapt to changes in cloud-enabled hardware, software, networking, browser, security and database technologies. Any failure of our service to operate effectively with future infrastructure platforms and technologies could reduce the demand for our service, resulting in customer dissatisfaction and harm to our business. If we are unable to respond to these changes in a cost-effective manner, our service may become less marketable and less competitive or obsolete and our operating results may be negatively impacted. In addition, an increasing number of individuals within the enterprise are utilizing mobile devices to access the Internet and corporate resources and to conduct business. If we cannot effectively make our service available on these mobile devices and offer the information, services and functionality required by enterprises that widely use mobile devices, we may experience difficulty attracting and retaining customers.

A portion of our revenues are generated by sales to government entities and heavily regulated organizations, which are subject to a number of challenges and risks.

A portion of our sales are to governmental agencies. Additionally, many of our current and prospective customers, such as those in the financial services and health care industries, are highly regulated and may be required to comply with more stringent regulations in connection with subscribing to and implementing our service. Selling to these entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that we will successfully complete a sale. Furthermore, engaging in sales activities to foreign governments introduces incremental compliance risks specific to the Foreign Corrupt Practices Act, the UK Bribery Act and other similar statutory requirements prohibiting bribery and corruption in the jurisdictions in which we operate. Government and highly regulated entities often require contract terms that differ from our standard arrangements and impose compliance requirements that are complicated, require preferential pricing or “most favored nation” terms and conditions, or are otherwise time consuming and expensive to satisfy. Due to the additional requirements of the U.S. federal government, we are in the process of establishing compliance with the Federal Information Security Management Act and other federal standards relating to our operations, security controls, processes and architecture. Individual agencies also have unique requirements, such as requirements that we use U.S.-only personnel or a requirement to use our service in a non-hosted environment. If we undertake to meet special standards or requirements and do not meet them, we could be subject to increased liability from our customers or regulators. Even if we do meet them, the additional costs associated with providing our service to government and highly regulated customers could harm our margins. Moreover, changes in the underlying regulatory conditions that affect these types of customers could harm our ability to efficiently provide our service to them and to grow or maintain our customer base.

Failure to effectively expand our sales and marketing capabilities could harm our ability to increase our customer base and achieve broader market acceptance of our service.

Increasing our customer base and achieving broader market acceptance of our service will depend, to a significant extent, on our ability to effectively expand our sales and marketing operations and activities. We are substantially dependent on our direct sales force to obtain new customers. From September 30, 2012 to September 30, 2013, our sales and marketing organization increased from 330 to 581 employees. We plan to continue to expand our direct sales force both domestically and internationally. We believe there is significant competition for direct sales personnel with the sales skills and technical knowledge that we require. Our ability to achieve significant revenue growth in the future will depend, in large part, on our success in recruiting, training and retaining a sufficient number of direct sales personnel. New hires require significant training and time before they achieve full productivity, particularly in new sales territories. Our recent hires and planned hires may not become as productive as quickly as we would like, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do business. Because we do not have a long history of expansion in our sales force, we cannot predict whether or to what extent our sales will increase as we expand our sales force or how long it will take for sales personnel to become productive. Moreover, we do not have significant experience as an organization developing and implementing overseas marketing campaigns,

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and such campaigns may be expensive and difficult to implement. Our business will be harmed if our expansion efforts do not generate a significant increase in revenues.

Our current management team is new and if we lose key members of our management team or are unable to attract and retain executives and employees we need to support our operations and growth, our business may be harmed.

Each of our executive officers either joined us within the past three years or has taken on a new role in the organization. These changes in our executive management team may be disruptive to our business. Our success depends substantially upon the continued services of this group of executive officers, particularly Frank Slootman, our Chief Executive Officer and Frederic B. Luddy, our founder and Chief Product Officer, who are critical to our vision, strategic direction, culture, services and technology. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives. Our executive officers are generally employed on an at-will basis, which means that our executive officers could terminate their employment with us at any time. The loss of one or more of our executive officers or the failure by our executive team to effectively work with our employees and lead our company could harm our business.

In the technology industry, there is substantial and continuous competition for engineers with high levels of experience in designing, developing and managing software and Internet-related solutions, as well as competition for sales executives and operations personnel. We may not be successful in attracting and retaining qualified personnel. We have from time to time experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. In particular, competition for experienced software and cloud-based infrastructure engineers in San Diego, San Jose, Seattle, London and Amsterdam, our primary operating locations, is intense. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be harmed.

Our quarterly results may fluctuate, and if we fail to meet the expectations of analysts or investors or our previously issued guidance, our stock price and the value of your investment could decline substantially.

Our quarterly financial results may fluctuate as a result of a variety of factors, many of which are outside of our control. If our quarterly financial results fall below the expectations of investors or any securities analysts who follow our stock, or fail to meet or exceed any forward guidance we issue, the price of our common stock could decline substantially. Some of the important factors that may cause our revenues, operating results and cash flows to fluctuate from quarter to quarter include:

- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' requirements;
- the number of new employees added;
- the rate of expansion and productivity of our sales force;
- changes in the relative and absolute levels of professional services we provide;
- the cost, timing and management effort for the development of new services;
- the length of the sales cycle for our service;
- changes in our pricing policies whether initiated by us or as a result of competition;
- the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;
- significant security breaches, technical difficulties or interruptions of our service;
- new solutions, products or changes in pricing policies introduced by our competitors;
- changes in foreign currency exchange rates;
- changes in effective tax rates;
-

general economic conditions that may adversely affect either our customers' ability or willingness to purchase additional subscriptions, delay a prospective customer's purchasing decision, reduce the value of new subscription contracts, or affect renewal rates;

- changes in deferred revenue balances due to the seasonal nature of our customer invoicing, changes in the average duration of our customer agreements, the rate of renewals and the rate of new business growth;
- the timing of customer payments and payment defaults by customers;
- extraordinary expenses such as litigation or other dispute-related settlement payments;

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- the impact of new accounting pronouncements; and
- the timing of stock awards to employees and the related adverse financial statement impact of having to expense those stock awards ratably over their vesting schedules.

Many of these factors are outside of our control, and the occurrence of one or more of them might cause our operating results to vary widely. As such, we believe that quarter-to-quarter comparisons of our revenues, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

We expect our revenue growth rate to decline, and as our costs increase, we may not be able to generate sufficient revenue to generate or sustain profitability or positive cash flow from operations, net of our investments, over the long term.

From three months ended September 30, 2009 to the three months ended September 30, 2013, our revenues grew from $6.0 million to $111.3 million. We expect that, in the future, as our revenues increase to higher levels, our revenue growth rate will decline. However, we may not be able to generate sufficient revenues to achieve and sustain profitability as we also expect our costs to increase in future periods. We expect to continue to expend substantial financial and other resources on:

- our technology infrastructure, including enhancements to our cloud architecture and hiring of additional employees for our research and development team;
- software development, including investments in our software development team, the development of new features and the improvement of the scalability, availability and security of our service;
- sales and marketing, including a significant expansion of our direct sales organization;
- international expansion in an effort to increase our customer base and sales; and
- general administration, including legal and accounting expenses related to being a public company.

These investments may not result in increased revenues or growth in our business. We may be unable to generate positive cash flow from operations, net of investments. If we fail to continue to grow our revenues and overall business, our operating results and business would be harmed.

Because we recognize revenues from our subscription service over the subscription term, downturns or upturns in new sales and renewals will not be immediately reflected in our operating results.

We generally recognize revenues from customers ratably over the terms of their subscriptions, which on average are approximately 35 months in duration for initial contract terms, although terms can range from 12 to 120 months. As a result, most of the revenues we report in each quarter are derived from the recognition of deferred revenues relating to subscriptions entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any single quarter will likely have only a small, and perhaps no apparent, impact on our revenue results for that quarter. Such a decline, however, will negatively affect our revenues in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our service, and potential changes in our rate of renewals may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenues through additional sales in any period, as revenues from new customers must be recognized over the applicable subscription term. In addition, we may be unable to adjust our cost structure to reflect the changes in revenues.

If we are unable to successfully manage the growth of our professional services business and improve our profit margin from these services, our operating results will be harmed.

Our professional services business, which performs implementation and configuration of our subscription service and training for our customers, has grown as our revenues from subscriptions have grown. We believe our investment in professional services facilitates the adoption of our subscription service. As a result, our sales efforts have been focused primarily on our subscription service, rather than the profitability of our professional services business. Historically, our pricing for professional services was predominantly on a fixed-fee basis and the cost of the time and materials incurred to complete these services was greater than the amount charged to the customer. These factors contributed to our gross profit and loss percentages from professional services and other of 1% and (6)% for the three months ended September 30, 2013 and 2012, respectively, and 12% and (6)% for the nine months ended September 30, 2013 and 2012, respectively. Included in the gross profit and loss percentages from professional services are revenues from our annual Knowledge user conference which contributed to 9 percentage points for each of the nine months ended September 30, 2013 and 2012. If we are unable to manage the growth of our professional services business and sustain our projected utilization rate for our professional services personnel, our operating results, including our profit margins, will be harmed.

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We may be sued by third parties for alleged infringement of their proprietary rights.

There is considerable patent and other intellectual property development activity in our industry. Our success depends in part on not infringing upon the intellectual property rights of others, however, we may be unaware of the intellectual property rights of others that may cover some or all of our technology or services. From time to time, our competitors or other third parties may claim that we are infringing upon their intellectual property rights, and we may be found to be infringing upon such rights. In the future, we may receive claims that our applications and underlying technology infringe or violate the claimant's intellectual property rights. Any claims or litigation could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, prevent us from offering our service, or require that we comply with other unfavorable terms. We may also be obligated to indemnify our customers or business partners in connection with any such litigation and to obtain licenses, modify our service or refund fees, which could further exhaust our resources. In addition, we may pay substantial settlement costs to resolve claims or litigation, whether or not legitimately or successfully asserted against us, which could include royalty or settlement payments in connection with any such litigation or to obtain licenses, modify our service or refund fees, which could further exhaust our resources. Even if we were to prevail in the event of claims or litigation against us, any claim or litigation regarding our intellectual property could be costly and time-consuming and divert the attention of our management and key personnel from our business operations. Such disputes could also disrupt our service, causing an adverse impact to our customer satisfaction and related renewal rates.

Our use of "open source" software could harm our ability to sell our service and subject us to possible litigation.

A significant portion of the technologies licensed or developed by us incorporate so-called "open source" software, and we may incorporate open source software into other services in the future. We attempt to monitor our use of open source software in an effort to avoid subjecting our service to conditions we do not intend; however, there can be no assurance that our efforts have been or will be successful. There is little or no legal precedent governing the interpretation of the terms of open source licenses, and therefore the potential impact of these terms on our business is uncertain and enforcement of these terms may result in unanticipated obligations regarding our service and technologies. For example, depending on which open source license governs open source software included within our service or technologies, we may be subjected to conditions requiring us to offer our service to users at no cost; make available the source code for modifications and derivative works based upon, incorporating or using the open source software; and license such modifications or derivative works under the terms of the particular open source license.

If an author or other third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal costs defending ourselves against such allegations, we could be subject to significant damages or be enjoined from the distribution of our service. In addition, if we combine our proprietary software with open source software in a certain manner, under some open source licenses we could be required to release the source code of our proprietary software, which could substantially help our competitors develop solutions that are similar to or better than our service.

Any failure to protect our intellectual property rights could impair our differentiation or hurt our brand.

Our success depends to a significant degree on our ability to protect our proprietary technology and our brand. We rely on a combination of copyright, trade secret and other intellectual property laws and confidentiality procedures to protect our proprietary rights. If we fail to protect our intellectual property rights adequately, our competitors may gain access to our technology and our business may be harmed. In addition, defending our intellectual property rights might entail significant expense and may result in counter-claims with respect to infringement of intellectual property rights by us. Any of our trademarks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. We have only recently begun to develop a strategy to seek, and may be

unable to obtain, patent protection for our technology. In addition, any patents issued in the future may not provide us with competitive advantages, or may be successfully challenged by third parties. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our service is available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States, and mechanisms for enforcement of intellectual property rights may be inadequate. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property.

We may be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel.

Our growth depends in part on the success of our strategic relationships with third parties and their continued performance.

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We anticipate that we will continue to depend on various third parties, such as sales partners, implementation partners, systems integrators and managed services providers, in order to grow our business. Identifying and qualifying these and other partners, and negotiating and documenting relationships with them, require significant time and resources. Our agreements with partners are typically non-exclusive and do not prohibit them from working with our competitors or from offering competing solutions. Our competitors may be effective in providing incentives to third parties, including our partners, to favor their solutions or to prevent or reduce subscriptions to our service either by disrupting our relationship with existing customers or by limiting our ability to win new customers. In addition, global economic conditions could harm the businesses of our partners, and it is possible that they may not be able to devote the additional resources we expect to the relationship. If we are unsuccessful in establishing or maintaining our relationships with these third parties, our ability to compete in the marketplace or to grow our revenues could be impaired and our operating results would suffer. Even if we are successful, we cannot assure you that these relationships will result in greater customer usage of our service or increased revenues.

If a customer is not satisfied with the quality of work performed by us or a third party, we could incur additional costs to address the situation, the profitability of that work might be impaired, and the customer's dissatisfaction with our professional services could damage our reputation or ability to obtain additional revenues from that customer or prospective customers.

Sales to customers outside North America expose us to risks inherent in international sales.

Because we sell our service throughout the world, we are subject to risks and challenges that we would otherwise not face if we conducted our business only in North America. Sales outside of North America represented 31% and 30% of our total revenues for the three and nine months ended September 30, 2013, and we intend to continue to expand our international sales efforts. Our business and future prospects depend on increasing our international sales as a percentage of our total revenues, and the failure to grow internationally will harm our business. The risks and challenges associated with sales to customers outside North America are different in some ways from those associated with sales in North America and we have a limited history addressing those risks and meeting those challenges. Furthermore, the business conduct and ethical standards of many other countries are substantially different and much less rigorous than the United States. The risks and challenges inherent with international sales include:

- localization of our service, including translation into foreign languages and associated expenses;
- differing laws and business practices, which may favor local competitors;
- longer sales cycles;
- compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy and data protection laws and regulations;
- treatment of revenues from international sources and changes to tax codes, including being subject to foreign tax laws and being liable for paying withholding, income or other taxes in foreign jurisdictions;
- regional data privacy laws that apply to the transmission of our customers' data across international borders;
- foreign currency fluctuations and controls;
- different pricing environments;
- differing cultural environments;
- difficulties in staffing and managing foreign operations;
- different or lesser protection of our intellectual property;
- longer accounts receivable payment cycles and other collection difficulties;
- regional economic conditions; and
- regional political conditions.

Any of these factors could negatively impact our business and results of operations.

We face exposure to foreign currency exchange rate fluctuations.

We conduct significant transactions, including intercompany transactions, in currencies other than the United States dollar or the functional operating currency of the transactional entities. In addition, our international subsidiaries maintain significant net assets that are denominated in currencies other than the functional operating currencies of these entities. Accordingly, changes

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in the value of foreign currencies relative to the United States dollar can affect our revenues and operating results due to transactional and translational remeasurement that is reflected in our earnings. We do not currently maintain a program to hedge transactional exposures in foreign currencies. However, in the future, we may use derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place. Moreover, the use of hedging instruments may introduce additional risks if we are unable to structure effective hedges with such instruments. It is particularly difficult to forecast any impact from exchange rate movements, so there is a material risk that unanticipated currency fluctuations could adversely affect our results or cause our results to differ from investor expectations or our own guidance in any future periods.

Weakened global economic conditions may harm our industry, business and results of operations.

Our overall performance depends in part on worldwide economic conditions, which may remain challenging for the foreseeable future. Global financial developments seemingly unrelated to us or the IT industry may harm us. The United States and other key international economies have been impacted by falling demand for a variety of goods and services, restricted credit, poor liquidity, reduced corporate profitability, volatility in credit, equity and foreign exchange markets, bankruptcies and overall uncertainty with respect to the economy. These conditions affect the rate of information technology spending and could adversely affect our customers' ability or willingness to purchase our service, delay prospective customers' purchasing decisions, reduce the value or duration of their subscriptions, or affect renewal rates, all of which could harm our operating results.

Changes in laws, regulations and standards related to the Internet may cause our business to suffer.

Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws and regulations affecting data privacy and the use of the Internet as a commercial medium. Industry organizations also regularly adopt and advocate for new standards in this area. For instance, we believe increased regulation is likely in the area of data privacy, and changing laws, regulations and standards applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers' ability to use and share data, potentially restricting our ability to store, process and share data with our customers. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet, commerce conducted via the Internet or validation that particular processes follow the latest standards. These changes could limit the viability of Internet-based services such as ours. If we are not able to adjust to changing laws, regulations and standards related to the Internet, our business may be harmed.

Unanticipated changes in our effective tax rate could harm our future results.

We are subject to income taxes in the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of earnings and losses in differing jurisdictions. Our effective tax rate could be adversely affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses as a result of acquisitions, the valuation of deferred tax assets and liabilities and changes in federal, state or international tax laws and accounting principles. Increases in our effective tax rate would reduce our profitability or in some cases increase our losses.

In addition, we may be subject to income tax audits by many tax jurisdictions throughout the world, many of which have not established clear guidance on the tax treatment of SaaS-based companies. Although we believe our income tax liabilities are reasonably estimated and accounted for in accordance with applicable laws and principles, an adverse resolution of one or more uncertain tax positions in any period could have a material impact on the results of operations for that period.

Natural disasters and other events beyond our control could harm our business.

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control. Although we maintain crisis management and disaster response plans, such events could make it difficult or impossible for us to deliver our service to our customers, and could decrease demand for our service. The majority of our research and development activities, corporate offices, information technology systems, and other critical business operations are located near major seismic faults in California. Customer data could be lost, significant recovery time could be required to resume operations and our financial condition and operating results could be harmed in the event of a major earthquake or catastrophic event.

We are an “emerging growth company,” and any decision on our part to comply with certain reduced disclosure requirements applicable to emerging growth companies could make our common stock less attractive to investors.

We are an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act enacted in April 2012, and, for as long as we continue to be an emerging growth company, we may choose to take advantage of exemptions from various

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reporting requirements applicable to other public companies including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We cannot predict if investors will find our common stock less attractive if we choose to rely on these exemptions. If some investors find our common stock less attractive as a result of any choices to reduce future disclosure, there may be a less active trading market for our common stock and our stock price may be more volatile. We will cease to be an "emerging growth company" as of December 31, 2013, as the market value of our common stock that is held by non-affiliates exceeded $700 million as of June 30, 2013.

Under Section 107(b) of the Jumpstart Our Business Startups Act, emerging growth companies can delay adopting new or revised accounting standards until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, we will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

We incur significant costs as a result of operating as a public company and our management has to devote substantial time to public company communications and compliance obligations.

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. The Sarbanes-Oxley Act and other legislation and rules implemented by the Securities and Exchange Commission, or SEC, and the New York Stock Exchange impose various requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel need to devote a substantial amount of time to these compliance requirements. These burdens may increase as new legislation is passed and implemented, including any new requirements that the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 may impose on public companies. Moreover, these rules and regulations, along with compliance with accounting principles and regulatory interpretations of such principles, have increased and will continue to increase our legal, accounting and financial compliance costs and have made and will continue to make some activities more time-consuming and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial costs to maintain the same or similar coverage.

These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors or our board committees, or as executive officers.

If we do not remediate material weaknesses in our internal control over financial reporting or are unable to implement and maintain effective internal control over financial reporting in the future, the accuracy and timeliness of our financial reporting may be adversely affected.

Prior to our initial public offering in June 2012, we were a private company and historically had limited accounting personnel and other supervisory resources with which to adequately execute our accounting processes and effectively address our internal control over financial reporting. This lack of adequate accounting resources contributed to audit adjustments to our financial statements in the past.

In connection with our preparation of the financial statements for the year ended June 30, 2011 and the six months ended December 31, 2011, our independent registered public accounting firm identified control deficiencies in our internal control that constituted material weaknesses. A material weakness is defined under the standards issued by the Public Company Accounting Oversight Board as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our financial statements

will not be prevented or detected and corrected on a timely basis. The material weaknesses our independent registered public accounting firm identified related to the design and operation of policies and procedures for accounting and reporting control processes, performance of account review and analysis, the development and review of complex judgments and estimates, the preparation of the provision for income taxes and the identification, communication and accounting of significant contracts and agreements. These material weaknesses, which contributed to multiple audit adjustments, primarily resulted from our failure to maintain a sufficient number of personnel with an appropriate level of knowledge, experience and training in the application of U.S. generally accepted accounting principles, or GAAP.

During the six months ended December 31, 2011, we hired a new Chief Financial Officer, a new Vice President of Finance and several new finance and accounting managers which significantly increased our finance and accounting team's experience in GAAP and financial reporting for publicly traded companies. In September 2011, we engaged a third-party tax firm and in February 2012, we hired a Senior Manager of Internal Audit. In March 2012, we hired a Vice President of Tax to assist with the accounting for income taxes and review of complex tax accounting matters. Beginning in January 2013, we increased the staff of internal

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audit. In addition, we expect to retain consultants to advise us on making further improvements to our internal controls related to these accounting areas. We believe that these additional resources enable us to broaden the scope and quality of our internal review of underlying information related to financial reporting and to further enhance our financial review procedures, including both the accounting processes for income taxes and significant contracts and agreements.

We have taken steps to address the material weaknesses as disclosed in the preceding paragraphs and as a result, we believe that these material weaknesses have been remediated. However, we have not completed the necessary documentation and testing procedures under Section 404 of the Sarbanes-Oxley Act and cannot assure you that we will be able to implement and maintain an effective internal control over financial reporting in the future. Any failure to maintain such controls could severely inhibit our ability to accurately report our financial condition or results of operations.

The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. In particular, beginning with the year ending on December 31, 2013, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting, as required by Section 404(a) of the Sarbanes-Oxley Act. In addition, our independent registered public accounting firm will be required to attest to the effectiveness of our internal control over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act as of December 31, 2013, the date on which we will no longer be an emerging growth company. At such time, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. Moreover, our testing, or the subsequent testing by our independent registered public accounting firm, that must be performed may reveal other material weaknesses or that the material weaknesses described above have not been fully remediated. If we do not remediate the material weaknesses described above, or if other material weaknesses are identified or we are not able to comply with the requirements of Section 404 in a timely manner, our reported financial results could be materially misstated or could subsequently require restatement, we could receive an adverse opinion regarding our internal controls over financial reporting from our independent registered public accounting firm and we could be subject to investigations or sanctions by regulatory authorities. The remediation of this situation could require additional financial and management resources, further divert management's time and attention from the core business, hurt our reputation with investors, and the market price of our stock could decline.

We may acquire or invest in companies, which may divert our management’s attention, and result in additional dilution to our stockholders. We may be unable to integrate acquired businesses and technologies successfully or achieve the expected benefits of such acquisitions or investments.

In July 2013, with the acquisition of Mirror42, we completed our first acquisition and we may evaluate and consider other potential strategic transactions, including acquisitions of, or investments in, businesses, technologies, services, products and other assets in the future. We also may enter into relationships with other businesses to expand our service offerings or our ability to provide services in international locations, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing or investments in other companies. An acquisition, investment or business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, their software is not easily adapted to work with ours, or we have difficulty retaining the customers of any acquired business due to changes in ownership, management or otherwise. Acquisitions may also disrupt our business, divert our resources and require significant management attention that would otherwise be available for development of our existing business. Moreover, the anticipated benefits of any acquisition, investment or business relationship may not be realized or we may be exposed to unknown risks or liabilities.

Negotiating these transactions can be time-consuming, difficult and expensive, and our ability to close these transactions may often be subject to conditions or approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close. For one or more of those transactions, we may:

- issue additional equity securities that would dilute our stockholders;
- use cash that we may need in the future to operate our business;
- incur debt on terms unfavorable to us or that we are unable to repay;
- incur large charges or substantial liabilities;
- encounter difficulties retaining key employees of the acquired company or integrating diverse software codes or business cultures; and
- become subject to adverse tax consequences, substantial depreciation or deferred compensation charges.

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Risks Relating to Ownership of Our Common Stock

The market price of our common stock has historically been and is likely to continue to be volatile and could subject us to litigation.

The trading price of our common stock has been, and is likely to continue to be, volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. Since shares of our common stock were sold in our initial public offering in June 2012 at a price of $18.00 per share, our stock price has ranged from $22.62 to $53.11 through September 30, 2013. In addition, the trading prices of the securities of technology companies in general have been highly volatile, and the volatility in market price and trading volume of securities is often unrelated or disproportionate to the financial performance of the companies issuing the securities. Factors affecting the market price of our common stock include:

- variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue, and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;
- forward-looking statements related to future revenues and earnings per share;
- the net increases in the number of customers, either independently or as compared with published expectations of industry, financial or other analysts that cover our company;
- changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;
- announcements of technological innovations, new solutions or enhancements to services, strategic alliances or significant agreements by us or by our competitors;
- announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;
- announcements of customer additions and customer cancellations or delays in customer purchases;
- recruitment or departure of key personnel;
- disruptions in our service due to computer hardware, software or network problems, security breaches, or other man-made or natural disasters;
- the economy as a whole, market conditions in our industry, and the industries of our customers;
- trading activity by a limited number of stockholders who together beneficially own a majority of our outstanding common stock;
- the size of our market float; and
- any other factors discussed herein.

In addition, if the market for technology stocks or the stock market in general experiences uneven investor confidence, the market price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The market price of our common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not directly affect us. Some companies that have experienced volatility in the trading price of their stock have been the subject of securities class action litigation. If we are the subject of such litigation, it could result in substantial costs and a diversion of our management’s attention and resources.

We do not intend to pay dividends on our common stock so any returns will be limited to changes in the value of our common stock.

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. In addition, our ability to pay cash dividends on our common

stock may be prohibited or limited by the terms of any future debt financing arrangement. Any return to stockholders will therefore be limited to the increase, if any, of our stock price.

Our directors and executive officers beneficially own a significant percentage of our stock and are able to exert control over matters subject to stockholder approval.

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As of September 30, 2013, our directors and executive officers and their respective affiliates beneficially owned in the aggregate approximately 16% of our outstanding voting stock. Together, these stockholders have the ability to influence us through this ownership position. For example, these stockholders may be able to influence elections of directors, amendments of our organizational documents, or the approval of any merger, sale of assets, or other major corporate transaction. This may prevent or discourage unsolicited acquisition proposals or offers for our common stock that you may feel are in your best interest as one of our stockholders.

Sales of a substantial number of shares of our common stock in the public market by our existing stockholders could cause our stock price to fall.

Sales of a substantial number of shares of our common stock in the public market, or the perception that these sales might occur could depress the market price of our common stock and may make it more difficult for you to sell your common stock at a time and price that you deem appropriate. We are unable to predict the effect that sales may have on the prevailing market price of our common stock. In addition, certain holders of shares of our common stock are entitled to rights with respect to the registration of their shares under the Securities Act of 1933, as amended, or the Securities Act, Registration of these shares under the Securities Act would result in the shares becoming freely tradable without restriction under the Securities Act, except for shares held by our affiliates as defined in Rule 144 under the Securities Act. Any sales of securities by existing stockholders could have a material adverse effect on the trading price of our common stock.

Provisions in our restated certificate of incorporation and restated bylaws and Delaware law might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the market price of our common stock.

Our restated certificate of incorporation and restated bylaws contain provisions that could depress the market price of our common stock by acting to discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions among other things:

- establish a classified board of directors so that not all members of our board are elected at one time;
- permit the board of directors to establish the number of directors;
- provide that directors may only be removed “for cause” and only with the approval of 66 2/3% of our stockholders;
- require super-majority voting to amend some provisions in our restated certificate of incorporation and restated bylaws;
- authorize the issuance of “blank check” preferred stock that our board could use to implement a stockholder rights plan;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our restated bylaws; and
- establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company. Section 203 imposes certain restrictions on merger, business combinations and other transactions between us and holders of 15% or more of our common stock.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES
Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable.

ITEM 5. OTHER INFORMATION
None.

ITEM 6. EXHIBITS
EXHIBIT INDEX

Exhibit Number	Description of Document	Incorporated by Reference Form	File No.	Exhibit	Filed Herewith
31.1	Certification of Periodic Report by Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002				X
31.2	Certification of Periodic Report by Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002				X
32.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
32.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
101.INS**	XBRL Instance Document.				X
101.SCH**	XBRL Taxonomy Extension Schema Document.				X
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document.				X
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document.				X
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document.				X
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document.				X

* The certifications on Exhibit 32 hereto are deemed not “filed” for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, or otherwise subject to the liability of that Section. Such certifications will not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act.
** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not “filed” for purposes of Sections 11 or 12 of the Securities Act, are deemed not “filed” for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under those Sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SERVICENOW, INC.

Date: November 4, 2013	By:	/s/ Frank Slootman Frank Slootman President and Chief Executive Officer (On behalf of the Registrant)
Date: November 4, 2013	By:	/s/ Michael P. Scarpelli Michael P. Scarpelli Chief Financial Officer (As Principal Financial and Accounting Officer)