BOX INC
Form 10-Q
September 08, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO

Commission File Number 001-36805

Box, Inc.

(Exact name of registrant as specified in its charter)

Delaware	20-2714444
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

900 Jefferson Ave.

Redwood City, California 94063

(Address of principal executive offices and Zip Code)

(877) 729-4269

(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 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 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 definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

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

As of August 31, 2017, the number of shares of the registrant's Class A common stock outstanding was 105,876,070 and the number of shares of the registrant's Class B common stock outstanding was 27,889,042.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which statements involve substantial risks and uncertainties. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of these words or other similar terms or expressio that concern our expectations, strategy, plans or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our ability to maintain an adequate rate of revenue and billings growth and our expectations regarding such growth;
- our business plan and our ability to effectively manage our growth;
- our ability to achieve profitability and positive cash flow;
- our ability to achieve our long-term margin objectives;
- our expectations regarding our revenues mix;
- costs associated with defending intellectual property infringement and other claims;
- our ability to attract and retain end-customers;
- our ability to further penetrate our existing customer base;
- our expectations regarding our retention rate;
- our ability to displace existing products in established markets;
- our ability to expand our leadership position as a cloud content platform;
- our ability to timely and effectively scale and adapt our existing technology;
- our ability to innovate new products and bring them to market in a timely manner;
- our plans to further invest in our business, including investment in research and development, sales and marketing, our datacenter infrastructure and our professional services organization, and our ability to effectively manage such investments;
- our ability to expand internationally;
- the effects of increased competition in our market and our ability to compete effectively;
- the effects of seasonal trends on our operating results;
- our belief regarding the sufficiency of our cash, cash equivalents and our credit facilities to meet our working capital and capital expenditure needs for the next 12 months;
- our expectations concerning relationships with third parties;
- our ability to attract and retain qualified employees and key personnel;
- our ability to realize the anticipated benefits of our partnerships with third parties;
- our ability to maintain, protect and enhance our brand and intellectual property; and
- future acquisitions of or investments in complementary companies, products, services or technologies and our ability to successfully integrate such companies or assets.

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in the section titled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. We undertake no obligation to update publicly any forward-looking statements for any reason after the date of this Quarterly Report on Form 10-Q to conform these statements to actual results or to changes in our expectations, except as required by law.

You should read this Quarterly Report on Form 10-Q and the documents that we reference in this Quarterly Report on Form 10-Q and have filed with the SEC as exhibits to this Quarterly Report on Form 10-Q with the understanding that our actual future results, levels of activity, performance, and events and circumstances may be materially different from what we expect.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

BOX, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	July 31, 2017 (unaudited)	January 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$165,275	$177,391
Accounts receivable, net of allowance of $2,640 and $3,346	107,891	120,113
Prepaid expenses and other current assets	16,631	10,826
Deferred commissions	13,287	13,771
Total current assets	303,084	322,101
Property and equipment, net	117,083	117,176
Intangible assets, net	101	543
Goodwill	16,293	16,293
Restricted cash	26,543	26,781
Other long-term assets	10,606	10,780
Total assets	$473,710	$493,674
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$13,834	$6,658
Accrued compensation and benefits	25,121	30,415
Accrued expenses and other current liabilities	18,118	17,713
Capital lease obligations	17,266	13,748
Deferred revenue	220,682	228,656
Deferred rent	2,065	751
Total current liabilities	297,086	297,941
Debt, non-current	40,000	40,000
Capital lease obligations, non-current	26,037	21,697
Deferred revenue, non-current	20,157	13,328
Deferred rent, non-current	45,537	44,207
Other long-term liabilities	2,982	1,769
Total liabilities	431,799	418,942
Commitments and contingencies (Note 6)		

Stockholders' equity:		
Preferred stock, par value $0.0001 per share; 100,000 shares authorized, no shares issued and outstanding as of July 31 (unaudited) and January 31, 2017	—	—
Class A common stock, par value $0.0001 per share; 1,000,000 shares authorized; 105,689 shares (unaudited) and 67,831 shares issued and outstanding as of July 31 and January 31, 2017, respectively	8	7
Class B common stock, par value $0.0001 per share; 200,000 shares authorized; 27,994 shares (unaudited) and 62,780 shares issued and outstanding as of July 31 and January 31, 2017, respectively	5	6
Additional paid-in capital	1,006,516	960,144
Treasury stock	(1,177)	(1,177)
Accumulated other comprehensive income (loss)	58	(120)
Accumulated deficit	(963,499)	(884,128)
Total stockholders' equity	41,911	74,732
Total liabilities and stockholders' equity	$473,710	$493,674

See notes to condensed consolidated financial statements.

BOX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Revenue	$122,941	$95,713	$240,163	$185,868
Cost of revenue	32,778	27,602	65,501	55,461
Gross profit	90,163	68,111	174,662	130,407
Operating expenses:				
Research and development	34,042	28,265	67,576	55,172
Sales and marketing	73,271	60,186	143,934	119,658
General and administrative	21,846	17,579	42,127	32,088
Total operating expenses	129,159	106,030	253,637	206,918
Loss from operations	(38,996)	(37,919)	(78,975)	(76,511)
Interest expense, net	(236)	(189)	(515)	(365)
Other income, net	267	190	283	631
Loss before provision for income taxes	(38,965)	(37,918)	(79,207)	(76,245)
Provision for income taxes	320	184	164	432
Net loss	$(39,285)	$(38,102)	$(79,371)	$(76,677)
Net loss per common share, basic and diluted	$(0.30)	$(0.30)	$(0.60)	$(0.61)
Weighted-average shares used to compute net loss per share, basic and diluted	132,981	126,776	132,237	125,864

See notes to condensed consolidated financial statements.

BOX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Net loss	$(39,285)	$(38,102)	$(79,371)	$(76,677)
Other comprehensive income (loss)*:				
Changes in foreign currency translation adjustment	149	(49)	178	65
Net change in unrealized gain on available-for-sale investments	—	1	—	3
Other comprehensive income (loss)*:	149	(48)	178	68
Comprehensive loss	$(39,136)	$(38,150)	$(79,193)	$(76,609)

*Tax effect was not material
See notes to condensed consolidated financial statements.

BOX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$(39,285)	$(38,102)	$(79,371)	$(76,677)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	9,765	10,721	19,337	22,805
Stock-based compensation expense	24,067	19,064	47,013	35,153
Amortization of deferred commissions	5,368	4,605	10,358	9,376
Other	19	(25)	41	83
Changes in operating assets and liabilities:				
Accounts receivable, net	(25,124)	(17,555)	12,222	24,372
Deferred commissions	(5,835)	(4,149)	(8,619)	(6,406)
Prepaid expenses and other assets, current and noncurrent	(3,164)	2,664	(5,705)	2,437
Accounts payable	(121)	(550)	7,061	(284)
Accrued expenses and other liabilities	7,074	7,484	(3,893)	(19,214)
Deferred rent	1,189	144	1,719	2,654
Deferred revenue	16,524	10,820	(1,145)	(3,409)
Net cash used in operating activities	(9,523)	(4,879)	(982)	(9,110)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Sales of marketable securities	—	240	—	240
Maturities of marketable securities	—	471	—	7,057
Purchases of property and equipment	(1,013)	(771)	(1,797)	(11,747)
Proceeds from sale of property and equipment	2	72	29	76
Net cash (used in) provided by investing activities	(1,011)	12	(1,768)	(4,374)
CASH FLOWS FROM FINANCING ACTIVITIES:				-
Payment of borrowing costs	—	—	—	(93)
Proceeds from exercise of stock options, net of repurchases of early exercised stock options	2,957	1,969	5,413	4,215
Proceeds from issuances of common stock under employee stock purchase plan	—	—	8,881	9,016
Employee payroll taxes paid related to net share settlement of restricted stock units	(5,821)	(4,100)	(14,935)	(8,868)
Acquisition related contingent consideration	(991)	—	(991)	—

Payments of capital lease obligations	(4,176)	(2,312)	(7,912)	(3,261)
Net cash (used in) provided by financing activities	(8,031)	(4,443)	(9,544)	1,009
Effect of exchange rate changes on cash and cash equivalents	149	(49)	178	65
Net decrease in cash and cash equivalents	(18,416)	(9,359)	(12,116)	(12,410)
Cash and cash equivalents, beginning of period	183,691	182,690	177,391	185,741
Cash and cash equivalents, end of period	$165,275	$173,331	$165,275	$173,331
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest, net of amounts capitalized	$466	$555	$889	$788
Cash paid (received) for income taxes, net of tax refunds	188	(2)	733	116
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:				
Change in accrued equipment purchases	$2,054	$(2,180)	$890	$(15,024)
Purchases of property and equipment under capital lease	5,972	5,562	15,681	9,910
Change in unpaid tax related to capital lease	200	628	435	430
Change in unpaid taxes related to net share settlement of restricted stock units	—	(461)	—	—
Vesting of early exercised stock options and restricted stock units	—	—	—	11

See notes to condensed consolidated financial statements.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Description of Business and Basis of Presentation

Description of Business

We were incorporated in the state of Washington in April 2005, and were reincorporated in the state of Delaware in March 2008. We changed our name from Box.Net, Inc. to Box, Inc. in November 2011. Box provides a leading cloud content management platform that enables organizations of all sizes to securely manage cloud content while allowing easy, secure access and sharing of this content from anywhere, on any device.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of July 31, 2017 and the condensed consolidated statements of operations, the condensed consolidated statements of comprehensive loss and the condensed consolidated statements of cash flows for the three and six months ended July 31, 2017 and 2016, respectively, are unaudited. The condensed consolidated balance sheet data as of January 31, 2017 was derived from the audited consolidated financial statements that are included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2017 (the "Form 10-K"), which was filed with the Securities and Exchange Commission (the "SEC") on March 24, 2017. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in our Form 10-K. Other than items discussed under Recently Adopted Accounting Pronouncements, there have been no other material changes to our critical accounting policies and estimates during the six months ended July 31, 2017 from those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information. Accordingly, they do not include all of the financial information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of our management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in the Form 10-K, and include all adjustments necessary for the fair presentation of our balance sheet as of July 31, 2017, and our results of operations, including our comprehensive loss, and our cash flows for the three and six months ended July 31, 2017 and 2016. All adjustments are of a normal recurring nature. The results for the three and six months ended July 31, 2017 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2018.

Certain prior year balances have been reclassified to conform to the current year presentation. Such reclassifications did not affect total revenues, operating income or net income.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make, on an ongoing basis, estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ from these estimates. Such estimates include, but are not limited to, the determination of the allowance for accounts receivable, fair value of acquired intangible assets and goodwill, useful lives of acquired intangible assets and property and equipment, best estimate of selling price included in multiple-deliverable revenue arrangements, fair values of stock-based awards, legal contingencies, and the provision for income taxes, including related reserves, among others. Management bases its estimates on historical experience and on various other assumptions which management believes to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Certain Risks and Concentrations

Our financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, restricted cash and accounts receivable. Although we deposit our cash with multiple financial institutions, our deposits, at times, may exceed federally insured limits.

We sell to a broad range of customers, including resellers. Our revenue is derived substantially from the United States across a multitude of industries. Accounts receivable are derived from the delivery of our services to customers primarily located in the United States. We accept and settle our accounts receivable using credit cards, electronic payments and checks. A majority of our lower dollar value invoices are settled by credit card on or near the date of the invoice. We do not require collateral from customers to secure

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

accounts receivable. We maintain an allowance for accounts receivable based upon the expected collectability, which takes into consideration specific customer creditworthiness and current economic trends. We believe collections of our accounts receivable are reasonably assured based on the size, industry diversification, financial condition and past transaction history of our customers. As of July 31, 2017, one customer, which was a reseller, accounted for more than 10% of total accounts receivable. As of January 31, 2017, two customers, which were both resellers, accounted for more than 10% of total accounts receivable. No single customer, including resellers, represented over 10% of revenue for the three and six months ended July 31, 2017 and 2016.

We serve our customers and users from datacenter facilities operated by third parties. In order to reduce the risk of down time of our enterprise cloud content services, we have established datacenters and third-party cloud computing and hosting providers in various locations in the United States and abroad. We have internal procedures to restore services in the event of disaster at any one of our current datacenter facilities. Even with these procedures for disaster recovery in place, our cloud services could be significantly interrupted during the implementation of the procedures to restore services.

Geographic Locations

For the three and six months ended July 31, 2017, revenue attributable to customers in the United States and customers outside the United States was 79% and 21%, respectively. For the three and six months ended July 31, 2016, revenue attributable to customers in the United States and customers outside the United States was 83% and 17%, respectively. No other country outside of the United States comprised 10% or greater of our revenue for any of the periods presented.

Substantially all of our net assets are located in the United States. As of July 31, 2017 and January 31, 2017, property and equipment located in the United States was 99.7%.

Recently Issued Accounting Pronouncements

In November 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (“ASU”) 2016-18, Statement of Cash Flows: Restricted Cash. ASU 2016-18 requires entities to show the changes in cash, cash equivalents, and restricted cash in the statement of cash flows. Entities will no longer present transfers between cash and cash equivalents and restricted cash in the statement of cash flows. As of July 31, 2017 and January 31, 2017, we had $26.5 million and $26.8 million in restricted cash, respectively. Restricted cash consists of certificates of deposit related to our leases. The new standard is effective for us beginning February 1, 2018, with early adoption permitted. The new standard should be applied using a retrospective transition method to each period presented. We do not believe the adoption of ASU 2016-18 will have a material impact on our consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments- Credit Losses. ASU 2016-13 replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade receivables, loans, and other financial instruments, we will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. The new standard is effective for us beginning February 1, 2020 with early adoption permitted. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of the provisions of this new standard on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. ASU 2016-02 requires lessees to put most leases on their balance sheet while recognizing expense in a manner similar to existing accounting. The new accounting guidance is effective for us beginning February 1, 2019 with early adoption permitted. We will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. We are currently evaluating the impact of the provisions of this new standard on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 regarding ASC Topic 606, Revenue from Contracts with Customers. The standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also provides guidance on the recognition of sales commission costs related to obtaining customer contracts. In addition, the FASB issued subsequent ASUs, which serve to clarify certain aspects of ASU 2014-09. The standard will be effective for us beginning February 1, 2018, with early adoption permitted. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). We currently anticipate adopting the standard using the modified retrospective method that will result in a cumulative effect adjustment.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

We have established a cross-functional coordinated implementation team to implement the standard update related to the recognition of revenue from contracts with customers. We have identified, and are in the process of implementing, appropriate changes to our business processes, systems and controls to support recognition and disclosure under the new standard. Based on our ongoing evaluation, we believe the impacts of this ASU will be related to the capitalization and amortization of sales commissions, the timing of revenue recognition for certain sales contracts, and their respective disclosures. There will be a change to the period over which sales commissions will be amortized to align to an expected period of benefit and a change to the scope of capitalized sales commissions based on the definition of incremental costs of obtaining a contract. In addition, there will be a change in relation to the timing of revenue recognition for certain sales contracts, due primarily to the removal of the current limitation on contingent revenue. These changes are being evaluated to determine the potential impact to our financial statements and disclosures. We continue to assess all potential impacts of this ASU, so our preliminary conclusions may change.

Recently Adopted Accounting Pronouncements

In January 2017, FASB issued ASU 2017-04, Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment. ASU 2017-04 simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test. Under current guidance, Step 2 of the goodwill impairment test requires entities to calculate the implied fair value of goodwill in the same manner as the amount of goodwill recognized in a business combination by assigning the fair value of a reporting unit to all of the assets and liabilities of the reporting unit. The carrying value in excess of the implied fair value is recognized as goodwill impairment. Under the new standard, goodwill impairment is recognized based on Step 1 of the current guidance, which calculates the carrying value in excess of the reporting unit's fair value. The new standard is effective for us beginning February 1, 2020, with early adoption permitted.

We elected to early adopt ASU 2107-04 during the second quarter of fiscal year 2018. The adoption of this ASU had no impact on our condensed consolidated financial statements. We expect that adoption of this ASU will simplify the evaluation and recording of goodwill impairment charges, if any.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payment. ASU 2016-15 provides guidance on the classification of eight cash flow issues in order to reduce diversity in practice. As required by ASU 2016-15, contingent consideration payments made soon after a business combination should be classified as cash outflows for investing activities. Payments made thereafter should be classified as cash outflows for financing activities up to the amount of the original contingent consideration liability. Payments made in excess of the amount of the original contingent consideration liability should be classified as cash outflows for operating activities. The new standard is effective for us beginning February 1, 2018 with early adoption permitted.

We elected to early adopt ASU 2016-15 during the second quarter of fiscal year 2018. The new standard requires application using a retrospective transition method. We have evaluated the impact on a quantitative and qualitative basis and concluded it was not material to any of prior periods presented.

In April 2016, the FASB issued ASU 2016-09, Compensation- Stock Compensation. ASU 2016-09 changes the accounting for certain aspects of share-based payments to employees. The new guidance requires excess tax benefits and tax deficiencies to be recorded in the income statement. In addition, cash flows related to excess tax benefits will be presented as an operating activity on the cash flow statement. The standard also allows entities to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting, clarifies that all cash payments made on an employee's behalf for withheld shares should be presented as a financing activity on the cash flow statement, and provides an accounting policy election to account for forfeitures as they occur.

We adopted ASU 2016-09 during the first quarter of fiscal year 2018. As required by the standard, excess tax benefits recognized on stock-based compensation expense were prospectively reflected in our condensed consolidated statements of income as a component of the provision for income taxes rather than on the condensed consolidated balance sheet as a paid-in capital. Included in our net operating loss and research and development tax credit carryforwards are approximately $25.2 million of excess tax benefits from employee stock option exercises, for which we have not realized a deferred tax asset since it is fully offset by a valuation allowance, resulting in no impact to our condensed consolidated financial statements including any cumulative effect to accumulated deficit from previously unrecognized excess tax benefits. Our policy has been to classify cash flows related to excess tax benefits as part of operating activities and cash payments made on employee's behalf for withheld shares as part of financing activities, and thus, the adoption of this standard had no effect on our condensed consolidated statements of cash flows. Further, we did not elect an accounting policy change to record forfeitures as they occur and thus will continue to estimate the number of forfeitures expected to occur. Other amendments in the guidance did not impact our condensed consolidated financial statements.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Note 2. Fair Value Measurements

We define fair value as the exchange price that would be received from selling an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. We measure our financial assets and liabilities at fair value at each reporting period using a fair value hierarchy which requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's classification within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs may be used to measure fair value:

- Level 1—Observable inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2—Observable inputs are quoted prices for similar assets and liabilities in active markets or inputs other than quoted prices which are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.
- Level 3—Unobservable inputs which are supported by little or no market activity and which are significant to the fair value of the assets or liabilities. These inputs are based on our own assumptions used to measure assets and liabilities at fair value and require significant management judgment or estimation.

We measure restricted cash at fair value on a recurring basis. We classify this asset within Level 1 or Level 2 because they are valued using either quoted market prices for identical assets or inputs other than quoted prices which are directly or indirectly observable in the market, including readily-available pricing sources for the identical underlying security which may not be actively traded. We have restricted cash in the form of certificates of deposits of $26.5 million and $26.8 million as of July 31, 2017 and January 31, 2017, respectively, classified within Level 2.

Note 3. Balance Sheet Components

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	July 31, 2017	January 31, 2017
Prepaid expenses	$12,940	$9,256
Other current assets	3,691	1,570
Total prepaid expenses and other current assets	$16,631	$10,826

Property and Equipment, Net

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

	July 31, 2017	January 31, 2017
Servers	$156,297	$143,219
Leasehold improvements	64,457	64,379
Computer hardware and software	12,119	11,373
Furniture and fixtures	13,061	12,824
Construction in progress	6,477	5,882
Total property and equipment	252,411	237,677
Less: accumulated depreciation	(135,328)	(120,501)
Total property and equipment, net	$117,083	$117,176

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

As of July 31, 2017, the gross carrying amount of property and equipment included $61.7 million of servers and $3.7 million of construction in progress acquired under capital leases, and the accumulated depreciation of property and equipment acquired under these capital leases was $18.8 million. As of January 31, 2017, the gross carrying amount of property and equipment included $43.2 million of servers and related equipment and $5.6 million of construction in progress acquired under capital leases, and the accumulated depreciation of property and equipment acquired under these capital leases was $10.4 million.

Depreciation expense related to property and equipment was $9.7 million and $9.8 million for the three months ended July 31, 2017 and 2016, respectively, and $18.9 million and $20.4 million for the six months ended July 31, 2017 and 2016, respectively. Included in these amounts was depreciation expense for servers acquired under capital leases in the amount of $4.6 million and $1.6 million for the three months ended July 31, 2017 and 2016, respectively, and $8.4 million and $2.9 million for the six months ended July 31, 2017 and 2016, respectively. Construction in progress primarily consists of servers, networking equipment and storage infrastructure being provisioned in our datacenter facilities as well as leasehold improvements. In addition, the amounts of interest capitalized to property and equipment were not material for the three and six months ended July 31, 2017 and 2016.

Note 4. Acquisitions

Wagon Analytics, Inc.

On August 30, 2016, we entered into an agreement to license certain technology and hire certain employees from Wagon Analytics, Inc., a privately-held data analysis company, for a total purchase price of $2.0 million. This agreement has been accounted for as a business combination. The entire purchase price was allocated to goodwill. Goodwill is attributable to future growth and potential enhancement opportunities for our analytics platform. Goodwill is deductible for U.S. income tax purposes. Transaction costs related to this business combination were not material.

Results of operations for this business combination have been included in our consolidated statements of operations since the acquisition date and were not material. Pro forma results of operations for this business combination have not been presented because they were also not material to the consolidated results of operations.

Note 5. Goodwill and Intangible Assets

There was no goodwill activity for the three and six months ended July 31, 2017.

Intangible assets consisted of the following (in thousands):

	Weighted Average Useful Life (1)		Gross Value	Accumulated Amortization	Net Carrying Value
July 31, 2017					
Developed technology	2.5	years	$14,273	$ (14,273)	$ —
Trade name and other	6.9	years	1,201	(1,100)	101
Intangibles, net			$15,474	$ (15,373)	$ 101
January 31, 2017					
Developed technology	2.5	years	$14,273	$ (13,908)	$ 365
Trade name and other	6.9	years	1,201	(1,023)	178
Intangibles, net			$15,474	$ (14,931)	$ 543

(1) From the date of acquisition

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BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Intangible amortization expense was not material for the three months ended July 31, 2017 and was $0.9 million for the three months ended July 31, 2016. For the six months ended July 31, 2017 and 2016, intangible amortization expense was $0.4 million and $2.4 million, respectively. Amortization of acquired technology is included in cost of revenue and amortization for trade names is included in general and administrative expenses in the consolidated statements of operations. As of July 31, 2017, expected amortization expense for intangible assets was not material.

Note 6. Commitments and Contingencies

Letters of Credit

As of July 31, 2017 and January 31, 2017, we had letters of credit in the aggregate amount of $26.5 million and $26.8 million, respectively, in connection with our operating and capital leases. Letters of credit in connection with our facility leases are collateralized by certificates of deposit. Refer to Note 7 for additional details.

Leases

We have entered into various non-cancellable operating lease agreements for certain of our offices and datacenters with lease periods expiring primarily between fiscal years 2018 and 2029. Certain of these arrangements have free or escalating rent payment provisions and optional renewal clauses. We are also committed to pay a portion of the actual operating expenses under certain of these lease agreements. These operating expenses are not included in the table below.

We also entered into various capital lease arrangements to obtain servers for our operations. These agreements are typically for three to four years. The leases are secured by the underlying leased servers.

As of July 31, 2017, future minimum lease payments under non-cancellable capital and operating leases are as follows (in thousands):

Years ending January 31:	Capital Leases	Operating Leases, net of Sublease Income
Remainder of 2018	$9,512	$ 12,442
2019	16,283	28,068
2020	10,782	32,454
2021	7,297	33,398

2022	916	30,705
Thereafter	—	161,202
Total minimum lease payments	$44,790	$ 298,269
Less: amount representing interest	(1,487)	
Present value of minimum lease payments	$43,303	

We sublease certain floors of our headquarters and one floor of our office in San Francisco. These subleases have terms ranging from 19 to 49 months that will expire between fiscal 2018 and 2021. Non-cancellable sublease proceeds for the years ending January 31, 2018, 2019, 2020 and 2021 of $3.6 million, $5.8 million, $1.9 million and $1.7 million, respectively, are included in the table above.

We establish assets and liabilities for the present value of estimated future costs to return certain of our leased facilities to their original condition. Such assets are depreciated over the lease period into operating expense, and the recorded liabilities are accreted to the future value of the estimated restoration costs. We did not have material asset retirement obligations as of July 31, 2017 and January 31, 2017. In addition, sufficient information did not exist as of July 31, 2017 to reasonably estimate the fair value of asset retirement obligations for a Tokyo, Japan lease signed in April 2017.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

We recognize rent expense under our operating leases on a straight-line basis. Rent expense totaled $6.9 million and $4.2 million, net of sublease income of $1.9 million and $1.7 million for the three months ended July 31, 2017 and 2016, respectively, and rent expense totaled $12.2 million and $8.6 million, net of sublease income of $3.7 million and $3.2 million for the six months ended July 31, 2017 and 2016, respectively.

Purchase Obligations

As of July 31, 2017, future payments under non-cancellable contractual purchases, which relate primarily to datacenter operations and sales and marketing activities, are as follows (in thousands):

Years ending January 31:	
Remainder of 2018	$6,055
2019	21,533
2020	16,683
	$44,271

Legal Matters

In June 2013, Open Text S.A. (Open Text) filed a lawsuit against us in the U.S. District Court, Eastern District of Virginia, alleging that our core cloud software and Box Edit application infringed 12 patents of Open Text. This case was subsequently transferred to the U.S. District Court for the Northern District of California and, in February 2015, went to trial. In February 2015, the jury returned a verdict in which it awarded damages in favor of Open Text in a lump sum and fully paid-up royalty in the amount of $4.9 million. Both parties appealed certain aspects of the trial. While we continued to defend the lawsuit vigorously and continued to believe we had valid defense to Open Text's claims, we considered the issuance of the verdict a recognized subsequent event that provided additional evidence about conditions which existed as of January 31, 2015. Accordingly, as of January 31, 2015, we accrued $4.9 million in relation to the jury award and recorded an expense in the amount of $3.9 million for the year ended January 31, 2015, in relation to the portion of the jury award attributable to prior periods. The portion of the jury award attributable to future periods was recorded as an asset as of January 31, 2015. This asset was amortized over an estimated useful life of 14 months, and the amortization expense was $0.9 million for the year ended January 31, 2016. In addition, we deemed Open Text's claim for interest on the jury award amount to be probable and estimable for the first time in July 2015. As such, we accrued additional expenses in the aggregate amount of $0.7 million during the year ended January 31, 2016, in relation to the interest on the jury award amount.

On March 31, 2016, we entered into a Confidential Settlement and Release Agreement with Open Text (the "Settlement Agreement"), which fully settled the lawsuit and resulted in a full dismissal of the case against the Company. In connection with such settlement, we paid $3.75 million in total to Open Text, and our obligation to pay the jury award amount of approximately $4.9 million and all pre- and post-judgment interest was terminated. The parties agreed to drop all appeals pending in connection with the litigation and each agreed to certain standard mutual releases related to the subject matter of the suit. We recorded the settlement payment of $3.75 million, reversed previous related accruals and interest of $5.6 million, and recorded $0.1 million in recurring amortization for the asset, resulting in net income of $1.7 million in our condensed consolidated statement of operations for the three months ended April 30, 2016.

In addition to the litigation discussed above, from time to time, we are a party to litigation and subject to claims that arise in the ordinary course of business. We investigate these claims as they arise, and accrue estimates for resolution of legal and other contingencies when losses are probable and estimable. Although the results of litigation and claims cannot be predicted with certainty, we believe there was not at least a reasonable possibility that we had incurred a material loss with respect to such loss contingencies as of July 31, 2017.

Indemnification

We include service level commitments to our customers warranting certain levels of uptime reliability and performance and permitting those customers to receive credits in the event that we fail to meet those levels. In addition, our customer contracts often include (i) specific obligations that we maintain the availability of the customer's data through our service and that we secure customer content against unauthorized access or loss, and (ii) indemnity provisions whereby we indemnify our customers for third-party claims asserted against them that result from our failure to maintain the availability of their content or securing the same from unauthorized access or loss. To date, we have not incurred any material costs as a result of such commitments.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Our arrangements generally include certain provisions for indemnifying customers against liabilities if our products or services infringe a third party's intellectual property rights. It is not possible to determine the maximum potential amount under these indemnification obligations due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. To date, we have not incurred any material costs as a result of such obligations and have not accrued any material liabilities related to such obligations in the consolidated financial statements. In addition, we indemnify our officers, directors and certain key employees while they are serving in good faith in their respective capacities. To date, there have been no claims under any indemnification provisions.

Note 7. Debt

Line of Credit

In December 2015, we entered into a revolving credit facility (December 2015 Facility) with a lender in the amount of up to $40.0 million maturing in December 2017. The December 2015 Facility is denominated in U.S. dollars and, depending on certain conditions, each borrowing is subject to a floating interest rate equal to either the prime rate plus a spread of 0.25% to 2.75% or a reserve adjusted LIBOR rate (based on one, three or six-month interest periods) plus a spread of 1.25% to 3.75%. Although no minimum deposit is required for the December 2015 Facility, we are eligible for the lowest interest rate if we maintain at least $40 million in deposits with the lender. In addition, there is an annual fee of 0.2% on the total commitment amount. We drew $40.0 million at 1.82% (six month LIBOR plus 1.25%). Borrowings under the December 2015 Facility are collateralized by substantially all of our assets in the United States. It also contains various covenants, including covenants related to the delivery of financial and other information, the maintenance of quarterly financial covenants, as well as customary limitations on dispositions, mergers or consolidations and other corporate activities. As of July 31, 2017, we were in compliance with all financial covenants. In February 2017, we amended the December 2015 Facility to extend the maturity date to December 2018. Interest expense, net of capitalized interest costs, for the periods presented is not material.

Note 8. Stock-Based Compensation

2015 Equity Incentive Plan

In January 2015, our board of directors adopted the 2015 Equity Incentive Plan (2015 Plan), which became effective prior to the completion of our initial public offering (IPO). A total of 12,200,000 shares of Class A common stock was initially reserved for issuance pursuant to future awards under the 2015 Plan. On the first day of each fiscal year, shares available for issuance are increased based on the provisions of the 2015 Plan. Any shares subject to outstanding awards under our 2006 Equity Incentive Plan (2006 Plan) or 2011 Equity Incentive Plan (2011 Plan) that are cancelled or repurchased subsequent to the 2015 Plan's effective date are returned to the pool of shares reserved for issuance under the 2015 Plan. Awards granted under the 2015 Plan may be (i) incentive stock options, (ii) nonstatutory stock options, (iii) restricted stock units, (iv) restricted stock awards or (v) stock appreciation rights, as determined by our board of directors at the time of grant. Options and restricted stock units generally vest 25% one year from the vesting commencement date and (a) in the case of options, $1/48^{th}$ per month thereafter, and (b) in the case of restricted stock units, 1/16th per quarter thereafter. As of July 31, 2017, 17,308,516 shares were reserved for future issuance under the 2015 Plan.

2015 Employee Stock Purchase Plan

In January 2015, our board of directors adopted the 2015 Employee Stock Purchase Plan (2015 ESPP), which became effective prior to the completion of our IPO. A total of 2,500,000 shares of Class A common stock was initially reserved for issuance under the 2015 ESPP. On the first day of each fiscal year, shares available for issuance are increased based on the provisions of the 2015 ESPP. The 2015 ESPP allows eligible employees to purchase shares of our Class A common stock at a discount of up to 15% through payroll deductions of their eligible compensation, subject to any plan limitations. Except for the initial offering period, the 2015 ESPP provides for 24-month offering periods beginning March 16 and September 16 of each year, and each offering period consists of four six-month purchase periods.

On each purchase date, eligible employees will purchase our stock at a price per share equal to 85% of the lesser of (1) the fair market value of our stock on the offering date or (2) the fair market value of our stock on the purchase date. In the event the price is lower on the last day of any purchase price period, in addition to using that price as the basis for that purchase period, the offering period resets and the new lower price becomes the new offering price for a new 24 month offering period. As of July 31, 2017, 2,969,790 shares were reserved for future issuance under the 2015 ESPP.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Stock Options

The following table summarizes the stock option activity under the equity incentive plans and related information:

	Shares Subject to Options Outstanding			Weighted-Average	
	Shares		Weighted-Average Exercise Price	Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2017	12,318,800		$ 7.44	6.42	$ 119,606
Options granted	1,133,056		16.91		
Option exercised	(930,595	)	5.82		
Options forfeited/cancelled	(784,749	)	15.26		
Balance as of July 31, 2017	11,736,512		$ 7.96	6.12	$ 127,825
Vested and expected to vest as of July 31, 2017	11,628,379		$ 7.90	6.10	$ 127,359
Exercisable as of July 31, 2017	9,164,951		$ 6.11	5.49	$ 116,739

The aggregate intrinsic value of options vested and expected to vest and exercisable as of July 31, 2017 is calculated based on the difference between the exercise price and the current fair value of our common stock. The aggregate intrinsic value of exercised options for the six months ended July 31, 2017 and 2016 was $11.2 million and $15.4 million, respectively. The aggregate estimated fair value of stock options granted to employees that vested for the six months ended July 31, 2017 and 2016 was $4.8 million and $9.6 million, respectively. The weighted-average grant date fair value of options granted to employees during the six months ended July 31, 2017 and 2016 was $6.82 and $5.10 per share, respectively.

As of July 31, 2017, there was $14.3 million of unrecognized stock-based compensation expense related to outstanding stock options granted to employees that is expected to be recognized over a weighted-average period of 2.32 years.

In April 2017, the compensation committee of our board of directors approved and granted 475,000 performance-based stock options under the 2015 Plan to certain executive officers where vesting is subject to both the continued employment of the participant and the achievement of market based performance goals established by the Compensation Committee. Subject to the achievement of the performance goals, the performance-based options vest 25% one year from the vesting commencement date and 1/48th per month thereafter. The grant date fair value of these awards was determined using a Monte Carlo valuation model. During the three months ended July 31, 2017, 250,000 performance-based stock options were forfeited in connection with a participant's resignation of employment.

Restricted Stock Units

The following table summarizes the restricted stock unit activity under the equity incentive plans and related information:

	Number of Restricted Stock Units Outstanding	Weighted-Average Grant Date Fair Value
Unvested balance - January 31, 2017	11,822,316	$ 14.67
Granted	5,260,434	17.57
Vested, net of shares withheld for employee payroll taxes	(1,297,031)	13.68
Forfeited/cancelled, including shares withheld for employee payroll taxes	(1,603,930)	14.38
Unvested balance - July 31, 2017	14,181,789	$ 15.87

As of July 31, 2017, there was $197.4 million of unrecognized stock-based compensation expense related to outstanding restricted stock units granted to employees that is expected to be recognized over a weighted-average period of 2.93 years.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

2015 ESPP

As of July 31, 2017, there was $7.1 million of unrecognized stock-based compensation expense related to the 2015 ESPP that is expected to be recognized over the remaining term of the respective offering periods.

Stock-Based Compensation

The following table summarizes the components of stock-based compensation expense recognized in the consolidated statements of operations (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Cost of revenue	$2,663	$1,830	$5,131	$3,342
Research and development	9,554	7,348	18,714	13,872
Sales and marketing	7,934	6,416	15,674	11,646
General and administrative	3,916	3,470	7,494	6,293
Total stock-based compensation	$24,067	$19,064	$47,013	$35,153

Determination of Fair Value

We estimated the fair value of employee stock options and 2015 ESPP purchase rights using generally a Black-Scholes option pricing model with the following assumptions:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Employee Stock Options				
Expected term (in years)	5.5 - 6.0	5.5 - 6.0	5.5 - 6.0	5.5 - 6.0
Risk-free interest rate	1.8% - 2.0%	1.3% - 1.5%	1.8% - 2.4%	1.3% - 1.5%
Volatility	38 % - 39%	43%	38 % - 40%	43%
Dividend yield	0%	0%	0%	0%
Employee Stock Purchase Plan				
Expected term (in years)	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0
Risk-free interest rate	0.9% - 1.4%	0.5% - 0.9%	0.9% - 1.4%	0.5% - 0.9%
Volatility	28 % - 43%	46 % - 60%	28 % - 43%	46 % - 60%
Dividend yield	0%	0%	0%	0%

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

Fair Value of Common Stock. Prior to our IPO in January 2015, our board of directors considered numerous objective and subjective factors to determine the fair value of our common stock at each grant date. These factors included, but were not limited to, (i) contemporaneous valuations of our common stock performed by unrelated third-party specialists; (ii) the prices for our redeemable convertible preferred stock sold to outside investors; (iii) the rights, preferences and privileges of our redeemable convertible preferred stock relative to our common stock; (iv) the lack of marketability of our common stock; (v) developments in the business; and (vi) the likelihood of achieving a liquidity event, such as an IPO or a merger or acquisition, given prevailing market conditions.

Subsequent to the completion of our IPO, we use the market closing price for our Class A common stock as reported on the New York Stock Exchange to determine the fair value of our common stock at each grant date.

Expected Term. The expected term represents the period that our share-based awards are expected to be outstanding. The expected term assumptions were determined based on the vesting terms, exercise terms and contractual lives of the options and 2015 ESPP purchase rights.

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Expected Volatility. Since we do not have sufficient trading history of our common stock, the expected volatility was derived from the historical stock volatilities of several unrelated public companies within the same industry that we consider to be comparable to our business over a period equivalent to the expected term of the stock option grants and 2015 ESPP purchase rights.

Risk-free Interest Rate. The risk-free rate that we use is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Dividend Yield. We have never declared or paid any cash dividends and do not plan to pay cash dividends in the foreseeable future, and, therefore, use an expected dividend yield of zero.

Note 9. Net Loss per Share

We calculate our basic and diluted net loss per share in conformity with the two-class method required for companies with participating securities. Under the two-class method, basic net loss per share is calculated by dividing the net loss by the weighted-average number of shares of common stock outstanding for the period, less shares subject to repurchase. The diluted net loss per share is computed by giving effect to all potential dilutive common stock equivalents outstanding for the period. For purposes of this calculation, options to purchase common stock, restricted stock units, employee stock purchase plan, repurchasable shares from early exercised options and unvested restricted stock, and contingently issuable shares are considered common stock equivalents but have been excluded from the calculation of diluted net loss per share as their effect is antidilutive.

The rights, including the liquidation and dividend rights, of the holders of our Class A and Class B common stock are identical, except with respect to voting and conversion. As the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis and the resulting net loss per share will, therefore, be the same for both Class A and Class B common stock on an individual or combined basis. We did not present dilutive net loss per share on an as-if converted basis because the impact was not dilutive.

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

	Three Months Ended July 31,			
	2017		2016	
	Class A	Class B	Class A	Class B
Numerator:				
Net loss	$(27,909)	$(11,376)	$(15,305)	$(22,797)

Denominator:				
Weighted-average number of shares outstanding—basic and diluted	94,471	38,510	50,925	75,851
Net loss per share—basic and diluted	$(0.30)	$(0.30)	$(0.30)	$(0.30)

	Six Months Ended July 31,			
	2017		2016	
	Class A	Class B	Class A	Class B
Numerator:				
Net loss	$(50,163)	$(29,208)	$(28,983)	$(47,694)
Denominator:				
Weighted-average number of shares outstanding—basic and diluted	83,574	48,663	47,575	78,289
Net loss per share—basic and diluted	$(0.60)	$(0.60)	$(0.61)	$(0.61)

BOX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

The following weighted-average outstanding shares of common stock equivalents were excluded from the computation of diluted net loss per share for the periods presented because the impact of including them would have been antidilutive (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Options to purchase common stock	12,345	13,782	12,267	14,338
Restricted stock units	13,624	10,218	13,088	9,305
Employee stock purchase plan	1,989	2,906	2,075	2,891
Repurchasable shares from early-exercised options and unvested restricted stock	214	346	227	370
Contingently issuable common stock	54	80	56	84
	28,226	27,332	27,713	26,988

Note 10. Income Taxes

Utilization of the net operating loss carryforwards and credits may be subject to substantial annual limitation due to the ownership change limitations provided by Section 382 of the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

We evaluate tax positions for recognition using a more-likely-than-not recognition threshold, and those tax positions eligible for recognition are measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon the effective settlement with a taxing authority that has full knowledge of all relevant information.

We file tax returns in the United States for federal, California, and other states. All tax years remain open to examination for both federal and state purposes as a result of our net operating loss and credit carryforwards. We file foreign tax returns in the United Kingdom starting with the year ended January 31, 2013, in France, Germany and Japan starting with the year ended January 31, 2014, in Canada starting with the year ended January 31, 2015, and in Australia, Sweden, and Netherlands starting with the year ended January 31, 2016. These tax years remain open to examination.

We believe that we have provided adequate reserves for our income tax uncertainties in all open tax years. We do not expect our gross unrecognized tax benefits to change significantly over the next 12 months.

Note 11. Segments

Our chief operating decision maker reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. As such, we have a single reporting segment and operating unit structure. Since we operate in one operating segment, all required segment information can be found in the consolidated financial statements.

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

You should read the following discussion and analysis of our financial condition and results of operations together with the condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed in the section titled "Risk Factors" and in other parts of this Quarterly Report on Form 10-Q.

Overview

Box provides a leading cloud content management platform that enables organizations of all sizes to securely manage cloud content while allowing easy, secure access and sharing of this content from anywhere, on any device. With our Software-as-a-Service (SaaS) cloud-based platform, users can collaborate on content both internally and with external parties, automate content-driven business processes, develop custom applications, and implement data protection, security and compliance features to comply with internal policies and industry regulations. Our platform enables a broad set of business use cases across an enterprise, across multiple file formats and media types, and user experiences. Our platform integrates with leading enterprise business applications, and is compatible with multiple application environments, operating systems and devices, ensuring that workers have access to their critical business content whenever and wherever they need it.

We were founded and publicly launched our platform in 2005 with a simple but powerful idea: to make it incredibly easy for people to securely manage, share and collaborate on their most important content online. In 2006, we introduced a free version of our product in order to rapidly grow our user base, and we surpassed one million registered users by July 2007. As users began to bring our solution into the workplace, we learned that businesses were eager for a solution to empower user-friendly content sharing and collaboration in a secure, manageable way. Starting in 2007, we began enhancing our platform to serve businesses and large enterprises, which meant expanding our business functionality with features such as our administrative console, identity integration, activity reporting and full-text search. To further satisfy the requirements of IT departments in large organizations, we began to invest heavily in enhancing the security of our platform. Also in 2007, we began to build an enterprise sales team. The continual evolution of our platform features allowed our sales team to sell into increasingly larger organizations. To empower users to work securely from anywhere, we built native applications for all major mobile platforms. The introduction of our iPad application in 2010 further accelerated enterprise adoption of our platform. In 2012, we introduced our Box OneCloud platform and our Box Embed framework to encourage developers and independent software vendors (ISVs) to build powerful applications that connect to Box, furthering the reach of the Box service. We continued to innovate by expanding our offerings to include Box KeySafe, a solution that builds on top of Box's strong encryption and security capabilities to give customers greater control over the encryption keys used to secure the file contents that are stored with Box; Box Governance, which gives customers a better way to comply with regulatory policies, satisfy e-discovery requests and effectively manage sensitive business information; Box Zones, which gives global customers the ability to store their data locally in certain regions; and Box Platform, which further enables customers and partners to build enterprise apps using the Box Platform. We continued to expand our international presence further with the opening of our international offices.

We offer our solution to our customers as a subscription-based service, with subscription fees based on the requirements of our customers, including the number of users and functionality deployed. The majority of our customers subscribe to our service through one-year contracts, although we also offer our services for terms ranging from one month to three years or more. We typically invoice our customers at the beginning of the term, in multiyear, annual, quarterly or monthly installments. We recognize subscription revenue ratably over the term of the subscription period.

Our objective is to build an enduring business that creates sustainable revenue and earnings growth over the long term. To best achieve this objective, we focus on growing the number of users and paying organizations through direct field sales, direct inside sales, indirect channel sales and through word-of-mouth by individual users, some of whom use our services at no cost. Individual users and organizations can also simply sign up to use our solution on our website. We believe this approach not only helps us build a critical mass of users but also has a viral effect within organizations as more of their employees use our service and encourage their IT professionals to deploy our services to a broader user base.

We have achieved significant growth in a short period of time. Our user base includes over 56 million registered users. We define a registered user as a Box account that has been provisioned to a unique user ID. As of July 31, 2017, over 17% of our registered users were paying users who register as part of a larger enterprise or business account or by using a personal account. We currently have over 76,000 paying organizations, and our solution is offered in 22 languages. We define paying organizations as separate and distinct buying entities, such as a company, an educational or government institution, or a distinct business unit of a large corporation, that have entered into a subscription agreement with us to utilize our services.

Organizations typically purchase our solution in the following ways: (i) employees in one or more small groups within the organization may individually purchase our service; (ii) organizations may purchase IT-sponsored, enterprise-level agreements with deployments for specific, targeted use cases ranging from tens to thousands of user seats; (iii) organizations may purchase IT- sponsored, enterprise-level agreements where the number of user seats sold is intended to accommodate and enable nearly all information workers within the organization in whatever use cases they desire to adopt over the term of the subscription; or (iv) organizations may purchase our Box Platform service to create custom business applications for their internal use and extended ecosystem of customers, suppliers and partners.

We intend to continue scaling our organization to meet the increasingly complex needs of our customers. Our sales and customer success teams are organized to efficiently serve organizations ranging from small businesses to the world's largest global organizations. We have invested, and expect to continue to invest in our sales and marketing teams to sell our services around the world, as well as in our development efforts to deliver additional features and capabilities of our cloud services to address our customers' evolving needs. We also expect to continue to make investments in both our infrastructure to meet the needs of our growing user base and our professional services organization (Box Consulting) to address the strategic needs of our customers in more complex deployments and to drive broader adoption across a wide array of use cases. As a result of our continuing investments to scale our business in each of these areas, we do not expect to be profitable for the foreseeable future.

For the six months ended July 31, 2017 and 2016, our revenue was $240.2 million and $185.9 million, respectively, representing year-over-year growth of 29%, and our net losses were $79.4 million and $76.7 million, respectively. For the six months ended July 31, 2017 and 2016, revenue from customers outside the United States represented 21% and 17% of our revenue, respectively. Box is headquartered in Redwood City, California and operates offices in California, New York, Texas, Amsterdam, London, Paris, Stockholm and Tokyo.

Our Business Model

Our business model focuses on maximizing the lifetime value of a customer relationship. We make significant investments in acquiring new customers and believe that we will be able to achieve a positive return on these investments by retaining customers and expanding the size of our deployments within our customer base over time. In connection with the acquisition of new customers, we incur and recognize significant upfront costs. These costs include sales and marketing costs associated with acquiring new customers, such as sales commission expenses, a significant portion of which is expensed upfront and the remaining portion of which is expensed over the length of the non-cancellable subscription term, and marketing costs, which are expensed as incurred. Due to our subscription model, we recognize revenue ratably over the term of the subscription period, which commences when all of the revenue recognition criteria have been met. Although our objective is for each customer to be profitable for us over the duration of our relationship, the costs we incur with respect to any customer relationship, whether a new customer or an expansion within an existing customer, may exceed revenue in earlier periods because we recognize those costs faster than we recognize the associated revenue.

Because of these dynamics, we experience a range of profitability with our customers depending in large part upon what stage of the customer phase they are in. We generally incur higher sales and marketing expenses for new customers and existing customers who are still in an expanding stage. For new customers, our associated sales and marketing expenses typically exceed the first year revenue we recognize from those customers. For customers who are expanding their use of Box, we incur various associated marketing expenses as well as sales commission expenses, though we typically recognize higher revenue than sales and marketing expenses. For typical customers who are renewing their Box subscriptions, our associated sales and marketing expenses are significantly less than the revenue we recognize from those customers. These differences are primarily driven by the higher compensation we provide to our sales force for new customers and customer subscription expansions compared to the compensation we provide to our sales force for routine subscription renewals by customers. In addition, our sales and marketing expenses, other than the compensation we provide to our sales force, are generally higher for acquiring new customers versus expansions or renewals of existing customer subscriptions. We believe that, over time, as our existing customer base grows and a relatively higher percentage of our revenue is attributable to renewals versus new or expanding Box deployments, we will experience lower associated sales and marketing expenses as a percentage of revenue.

Key Business Metrics

We use the key metrics below for financial and operational decision-making and as a means to evaluate period-to-period comparisons. We believe that these key metrics provide meaningful supplemental information regarding our performance. We believe that both management and investors benefit from referring to these key metrics in assessing our performance and when planning, forecasting, and analyzing future periods. These key metrics also facilitate management's internal comparisons to our historical performance as well as comparisons to our competitors' operating results. We believe these key metrics are useful to investors both because (1) they allow for greater transparency with respect to key metrics used by management in its financial and operational decision-making and (2) they are used by our institutional investors and the analyst community to help them analyze the health of our business.

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Billings (in thousands)	$139,465	$106,533	$239,018	$182,459
Billings growth rate	31 %	34 %	31 %	22 %
Free cash flow (in thousands)	(14,712)	(7,962)	(10,691)	(24,118)
Retention rate (period end)	113 %	115 %	113 %	115 %

Billings

Billings represent our revenue plus the change in deferred revenue in the period. Billings we record in any particular period primarily reflect sales to new customers plus subscription renewals and expansion within existing customers, and represent amounts invoiced for all of our products and professional services. We typically invoice our customers at the beginning of the term, in multiyear, annual, quarterly or monthly installments. If the customer elects to pay the full subscription amount at the beginning of the period, the total subscription amount for the entire term will be reflected in billings. If the customer elects to be invoiced annually or more frequently, only the amount billed for such period will be included in billings.

We believe that billings help investors better understand our sales activity for a particular period, which is not necessarily reflected in our revenue given that we recognize subscription revenue ratably over the subscription term. We consider billings a significant performance measure and after adjusting for any shifts in relative payment frequencies, a leading indicator of future revenue. We monitor billings to manage our business, make planning decisions, evaluate our performance and allocate resources. We believe that billings offer valuable supplemental information regarding the performance of our business and will help investors better understand the sales volumes and performance of our business. Although we consider billings to be a significant performance measure, we do not consider it to be a non-GAAP financial measure given that it is calculated using exclusively revenue and deferred revenue, both of which are financial measures calculated in accordance with GAAP.

Billings increased 31% in the six months ended July 31, 2017 over the six months ended July 31, 2016. The increase in billings was primarily driven by the addition of new customers with larger initial deployments, expansion of the number of users within existing customers, and an enhanced developer access fee from one of our resellers.

Our use of billings has the following limitations as an analytical tool and should not be considered in isolation or as a substitute for revenue or an analysis of our results as reported under GAAP. Billings are recognized when invoiced, while the related revenue is recognized ratably over the term of the subscription or premier support services. When we invoice customers more frequently than their subscription period, amounts not yet invoiced will not be reflected in deferred revenue or billings. Also, other companies, including companies in our industry, may not use billings, may calculate billings differently, may have different billing frequencies, or may use other financial measures to evaluate their performance, all of which could reduce the usefulness of billings as a comparative measure.

For the remainder of fiscal year 2018, we expect normalized payment durations. We expect our billings growth and revenue growth to correlate with one another which will mitigate fluctuations in billings not correlated to future revenue. In addition, as we have gained and expect to continue to gain more traction with large enterprise customers, we also anticipate our quarterly billings to increasingly concentrate in the back half of our fiscal year, especially in the fourth quarter.

A calculation of billings starting with revenue, the most directly comparable GAAP financial measure, is presented below (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
GAAP revenue	$122,941	$95,713	$240,163	$185,868
Deferred revenue, end of period	240,839	183,004	240,839	183,004
Less: deferred revenue, beginning of period	(224,315)	(172,184)	(241,984)	(186,413)
Billings	$139,465	$106,533	$239,018	$182,459

Free Cash Flow

We define free cash flow as cash used in operating activities less purchases of property and equipment, principal payments of capital lease obligations, and other items that did not or are not expected to require cash settlement and which management considers to be outside of our core business. We specifically identify other adjusting items in our reconciliation of GAAP to non-GAAP financial measures. Historically, these items have included restricted cash used to guarantee a significant letter of credit for our Redwood City headquarters. We consider free cash flow to be a profitability and liquidity measure that provides useful information to management and investors about the amount of cash generated by the business that can possibly be used for investing in our business and strengthening the balance sheet; but it is not intended to represent the residual cash flow available for discretionary expenditures. A reconciliation of free cash flow to cash used in operating activities, its nearest GAAP equivalent, is presented in the non-GAAP Financial Measures section of this report. The presentation of free cash flow is also not meant to be considered in isolation or as an alternative to cash flows from operating activities as a measure of liquidity.

Free cash flow for the six months ended July 31, 2017 was negative $10.7 million, an improvement of $13.4 million as compared to the six months ended July 31, 2016. The increase in free cash flow was primarily driven by a decrease in cash used by operations of $8.1 million and a decrease in capital expenditures of $10.0 million, partially offset by an increase in capital lease obligation payments of $4.7 million. The primary factors affecting the decrease in cash flow used in operations include the changes in our operating assets and liabilities of $1.5 million and improvement of our net loss adjusted for non-cash charges by $6.6 million. The decrease in capital expenditures was primarily due to a reduction in capital expenditures related to the completion of our new Redwood City headquarters. In addition, there was a reduction in expenditures for data center assets as well as more data center assets that were financed through capital leases. As we continue to invest in our data center operations, we expect capital lease obligations to increase in the foreseeable future. Our tighter working capital management and completion of Redwood City headquarters have driven significant improvements in free cash flow.

Retention Rate

We calculate our retention rate as of a period end by starting with the annual contract value (ACV) from customers with contract value of $5,000 or more as of 12 months prior to such period end (Prior Period ACV) and a subscription term of at least 12 months. We then calculate ACV from these same customers as of the current period end (Current Period ACV). Finally, we divide the aggregate Current Period ACV for the trailing 12 month period by the aggregate Prior Period ACV for the trailing 12 month period to arrive at our retention rate. We believe our retention rate is an important metric that provides insight into the long-term value of our subscription agreements and our ability to retain and grow revenue from our customer base. We focus on contracts that have a value of $5,000 or more because, over time, these customers give us the best indicator for the growth of our business and the potential for incremental business as they renew and expand their deployments, and contracts with these customers represented a substantial majority of our revenue for the six months ended July 31, 2017. Retention rate is an operational metric and there is no comparable GAAP financial measure to which we can reconcile this particular key metric.

Our retention rate was approximately 113% and 115% as of July 31, 2017 and 2016, respectively. The calculation of our retention rate reflects both net user expansion and the loss of customers who do not renew their subscriptions with us, which was below 5% of the Prior Period ACV. Our retention rates consistently exceeded 100% and were primarily attributable to an increase in user expansion. We believe our investments in product, Customer Success, and Box Consulting are driving our strong customer retention results. As we penetrate customer accounts, we expect our rate of growth in expansion to trend down over time but our retention rate to remain above 100% for the foreseeable future.

Components of Results of Operations

Revenue

We derive our revenue from three sources: (1) subscription revenue, which is comprised of subscription fees from customers utilizing our cloud content management platform and other subscription-based services, which all include routine customer support; (2) revenue from customers purchasing our premier support package; and (3) revenue from professional services such as implementing best practice use cases, project management and implementation consulting services.

To date, practically all of our revenue has been derived from subscription and premier support services. Subscription and premier support revenue is driven primarily by the number of customers, the number of seats sold to each customer and the price of our services.

Subscription and premier support revenue is recognized ratably over the contract term beginning on the later of the date the service is provisioned to the customer and the date all other revenue recognition criteria have been met. Our subscription and support contracts are typically non-cancellable and do not contain refund-type provisions. The majority of our customers subscribe to our service through one-year contracts, although we also offer our services for terms ranging between one month to three years or more. We typically invoice our customers at the beginning of the term, in multiyear, annual, quarterly or monthly installments. Amounts that have been invoiced are initially recorded as deferred revenue and are recognized ratably over the invoice period. Amounts that have not been invoiced are not reflected in deferred revenue.

Professional services revenue is recognized as the services are rendered for time and material contracts, and using the proportional performance method over the period the services are performed for fixed price contracts. Professional services revenue was not material for all periods presented.

Revenue is presented net of sales and other taxes we collect on behalf of governmental authorities.

Cost of Revenue

Our cost of revenue consists primarily of costs related to providing our cloud content management to our paying customers, including employee compensation and related expenses for datacenter operations, customer support and professional services personnel, payments to outside infrastructure service providers, depreciation of servers and equipment, security services and other tools, as well as amortization of acquired technology. We allocate overhead such as rent, information technology costs and employee benefit costs to all departments based on headcount. As such, general overhead expenses are reflected in cost of revenue and each of the operating expense categories set forth below. We expect our cost of revenue to increase in dollars and may increase as a percentage of revenue as we continue to invest in our datacenter operations and customer support to support the growth of our business, our customer base, as well as our international expansion.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing, and general and administrative expenses. Personnel costs are the most significant component of each category of operating expenses. Operating expenses also include allocated overhead costs for facilities, information technology costs and employee benefit costs.

Research and Development. Research and development expense consists primarily of employee compensation and related expenses, as well as allocated overhead. Our research and development efforts are focused on scaling our platform, adding enterprise grade features, functionality and security, and enhancing the ease of use of our cloud-based services. We expect our research and development expense to increase in dollars but decrease as a percentage of revenue over time, as we continue to invest in our future products and services.

Sales and Marketing. Sales and marketing expense consists primarily of employee compensation and related expenses, sales commissions, marketing programs, travel-related expenses, as well as allocated overhead. Marketing programs include but are not limited to advertising, events, corporate communications, brand building, and product marketing. Sales and marketing expense also consists of datacenter and customer support costs related to providing our cloud-based services to our free users. We market and sell our cloud-based services worldwide through our direct sales organization and through indirect distribution channels such as strategic resellers. We expect our sales and marketing expense to continue to increase in dollars but decrease as a percentage of revenue over time as we increase the size of our sales and marketing organization and expand our international presence.

General and Administrative. General and administrative expense consists primarily of employee compensation and related expenses for administrative functions including finance, legal, human resources, recruiting, information systems and fees for external professional services and cloud based enterprise systems as well as allocated overhead. External professional services fees are primarily comprised of outside legal, litigation, accounting, temporary services, audit and outsourcing services. We expect our general and administrative expense to increase in dollars but to decrease as a percentage of revenue over time due to increasing operational excellence and scale.

Interest Expense, Net

Interest expense, net consists of interest expense and interest income. Interest expense consists of interest charges for our line of credit, fees on our letter of credit, the amortization of capitalized debt issuance costs, and capital leases. Interest income consists of interest earned on our cash, cash equivalents, and restricted cash. We have historically invested our cash in overnight deposits and short term, investment-grade corporate debt, and asset backed securities.

Other Income, Net

Other income, net consists primarily of gains and losses from foreign currency transactions and other income (expense).

Provision for Income Taxes

Provision for income taxes consists primarily of income taxes in certain foreign jurisdictions in which we conduct business and state income taxes in the United States and, as applicable, changes in our deferred taxes and related allowance positions and uncertain tax positions.

Results of Operations

The following tables set forth our results of operations for the periods presented in dollars and as a percentage of our revenue:

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2017	2016	2017	2016
	(in thousands)		(in thousands)	
Revenue	$122,941	$95,713	$240,163	$185,868
Cost of revenue(1)(2)	32,778	27,602	65,501	55,461
Gross profit	90,163	68,111	174,662	130,407
Operating expenses:				
Research and development(2)				