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RingCentral Inc
Form 10-Q
November 07, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

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: 001-36089

RingCentral, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware 94-3322844
(State or other jurisdiction (I.R.S. Employer

of incorporation or organization) Identification No.)

20 Davis Drive

Belmont, California 94002

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(Address of principal executive offices)

(650) 472-4100

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

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

As of November 1, 2016, there were 60,474,474 shares of Class A Common Stock issued and outstanding and 13,109,918 shares of Class B Common Stock outstanding.

TABLE OF CONTENTS

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements (unaudited)</u>	5
<u>Condensed Consolidated Balance Sheets at September 30, 2016 and December 31, 2015</u>	5
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015</u>	6
<u>Condensed Consolidated Statements of Comprehensive Loss for the three and nine months ended September 30, 2016 and 2015</u>	7
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015</u>	8
<u>Notes to Condensed Consolidated Financial Statements</u>	9
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
Item 4. <u>Controls and Procedures</u>	31
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	32
Item 1A. <u>Risk Factors</u>	32
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	61
Item 3. <u>Default Upon Senior Securities</u>	61
Item 4. <u>Mine Safety Disclosures</u>	61
Item 5. <u>Other Information</u>	61
Item 6. <u>Exhibits</u>	61
<u>Signatures</u>	63

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to our management. The forward-looking statements are contained principally in, but not limited to, the sections titled "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations". Forward-looking statements include all statements that are not historical facts and can be identified by terms such as "anticipates", "believes", "could", "seeks", "estimates", "expects", "intends", "may", "plans", "potential", "predicts", "projects", "should", "will", "would" or similar expressions and the negatives of those expressions. Forward-looking statements include, but are not limited to, statements about:

- our success in the enterprise market and with our carrier partners;
- our progress against short term and long term goals;
- our future financial performance;
- our anticipated growth, growth strategies and our ability to effectively manage that growth and effect these strategies;
- anticipated trends, developments and challenges in our business and in the markets in which we operate, as well as general macroeconomic conditions;
- the impact of competition in our industry and innovation by our competitors;
- our ability to anticipate and adapt to future changes in our industry;
- our ability to predict software subscriptions revenues, formulate accurate financial projections, and make strategic business decisions based on our analysis of market trends;
- our ability to anticipate market needs and develop new and enhanced products and subscriptions to meet those needs, and our ability to successfully monetize them;
- maintaining and expanding our customer base;
- our anticipated benefits from our new sales agency agreement with Westcon Group;
- maintaining, expanding and responding to changes in our relationships with other companies;
- maintaining and expanding our distribution channels, including our network of sales agents and resellers;
- our ability to sell, market, and support our products and services;
- our ability to expand our business to medium-sized and larger customers as well as expanding domestically and internationally;
- our ability to realize increased purchasing leverage and economies of scale as we expand;
- the impact of seasonality on our business;
- the impact of any failure of our solutions or solution innovations;
- our reliance on our third-party product and service providers;
- the potential effect on our business of litigation to which we may become a party;
- our liquidity and working capital requirements;
- the impact of changes in the regulatory environment;
- our ability to protect our intellectual property and rely on open source licenses;
- our expectations regarding the growth and reliability of the internet infrastructure;
- the timing of acquisitions of, or making and exiting investments in, other entities, businesses or technologies;
- our ability to successfully and timely integrate, and realize the benefits of, our acquisition of Glip, Inc. and any other significant acquisitions we may make;
- our capital expenditure projections;
- the estimates and estimate methodologies used in preparing our condensed consolidated financial statements;

- the political environment and stability in the regions in which we or our subcontractors operate;
- the impact of economic downturns on us and our clients;
- our ability to defend our systems and our customer information from fraud and cyber attack;
- our ability to prevent the use of fraudulent payment methods for our products; and
- our ability to retain key employees and to attract qualified personnel.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance, or achievements to be significantly different from any future results, performance, or achievements expressed or implied by the forward-looking statements. We discuss these risks in greater detail in the section entitled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management’s beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be significantly different from what we expect.

Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ significantly from those anticipated in these forward looking statements, even if new information becomes available in the future.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands)

	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	\$ 152,390	\$ 137,588
Accounts receivable, net	23,583	19,163
Inventory	84	2,317
Prepaid expenses and other current assets	16,644	11,978
Total current assets	192,701	171,046
Property and equipment, net	31,139	28,160
Goodwill	9,393	9,393
Acquired intangibles, net	2,500	3,266
Other assets	3,064	2,948
Total assets	\$ 238,797	\$ 214,813
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 4,701	\$ 5,196
Accrued liabilities	46,368	34,702
Current portion of capital lease obligation	181	269
Current portion of long-term debt	14,528	3,750
Deferred revenue	42,738	36,657
Total current liabilities	108,516	80,574
Long-term debt	1,250	14,840
Sales tax liability	3,527	3,670
Capital lease obligation	—	181
Other long-term liabilities	3,402	5,416
Total liabilities	116,695	104,681
Commitments and contingencies (Note 8)		
Stockholders' equity		
Common stock	7	7
Additional paid-in capital	351,784	319,792

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Accumulated other comprehensive income	2,868	527
Accumulated deficit	(232,557)	(210,194)
Total stockholders' equity	122,102	110,132
Total liabilities and stockholders' equity	\$ 238,797	\$ 214,813

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

	Three Months		Nine Months Ended	
	Ended September 30, 2016	2015	September 30, 2016	2015
Revenues				
Software subscriptions	\$91,853	\$70,321	\$257,898	\$194,713
Other	4,986	6,459	17,323	18,076
Total revenues	96,839	76,780	275,221	212,789
Cost of revenues				
Software subscriptions	19,211	17,084	54,107	49,503
Other	4,244	5,249	13,452	14,906
Total cost of revenues	23,455	22,333	67,559	64,409
Gross profit	73,384	54,447	207,662	148,380
Operating expenses				
Research and development	16,490	13,475	48,097	37,612
Sales and marketing	50,306	34,878	137,796	101,473
General and administrative	13,649	11,922	41,114	34,231
Total operating expenses	80,445	60,275	227,007	173,316
Loss from operations	(7,061)	(5,828)	(19,345)	(24,936)
Other income (expense), net				
Interest expense	(176)	(245)	(585)	(927)
Other income (expense), net	(696)	(319)	(2,280)	(637)
Other income (expense), net	(872)	(564)	(2,865)	(1,564)
Loss before provision (benefit) for income taxes	(7,933)	(6,392)	(22,210)	(26,500)
Provision (benefit) for income taxes	46	(56)	153	(1,342)
Net loss	\$(7,979)	\$(6,336)	\$(22,363)	\$(25,158)
Net loss per common share				
Basic and diluted	\$(0.11)	\$(0.09)	\$(0.31)	\$(0.36)
Weighted-average number of shares used in computing net loss				
per share				
Basic and diluted	73,285	70,580	72,669	69,614

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited, in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net loss	\$(7,979)	\$(6,336)	\$(22,363)	\$(25,158)
Other comprehensive income/(loss)				
Foreign currency translation adjustments	665	159	2,341	146
Unrealized loss on available-for-sale securities	—	94	—	190
Comprehensive loss	\$(7,314)	\$(6,083)	\$(20,022)	\$(24,822)

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities		
Net loss	\$(22,363)	\$(25,158)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	10,749	9,935
Share-based compensation	22,603	15,790
Foreign currency remeasurement loss	2,450	315
Tax benefit from release of valuation allowance	—	(1,411)
Non-cash interest expense and other expenses related to debt	—	156
Net accretion of discount and amortization of premium on available-for-sale securities	—	602
Provision for bad debt	458	152
Deferred income taxes	(4)	5
Others	464	220
Changes in assets and liabilities:		
Accounts receivable	(4,878)	(7,688)
Inventory	2,233	(577)
Prepaid expenses and other current assets	(4,667)	(3,907)
Other assets	201	173
Accounts payable	(2,470)	(61)
Accrued liabilities	13,737	4,758
Deferred revenue	6,080	8,700
Other liabilities	(2,157)	204
Net cash provided by operating activities	22,436	2,208
Cash flows from investing activities		
Purchases of property and equipment	(9,634)	(11,106)
Capitalized internal-use software	(1,515)	(1,836)
Cash paid in business combination, net of cash acquired	—	(4,670)
Proceeds from the maturity of available-for-sale securities	—	25,760
Proceeds from the maturity of restricted investments	—	100
Net cash provided by (used in) investing activities	(11,149)	8,248
Cash flows from financing activities		
Proceeds from issuance of stock in connection with stock plans	8,268	12,040
Taxes paid related to net share settlement of equity awards	(131)	(105)
Payment of holdback from Glip acquisition	(1,500)	—
Repayment of debt	(2,813)	(5,205)
Repayment of capital lease obligations	(269)	(509)
Net cash provided by financing activities	3,555	6,221
Effect of exchange rate changes on cash and cash equivalents	(40)	145
Net increase in cash and cash equivalents	14,802	16,822
Cash and cash equivalents		
Beginning of period	137,588	113,182

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End of period	\$152,390	\$130,004
Supplemental disclosure of cash flow data		
Cash paid for interest	\$568	\$1,697
Cash paid for income taxes	\$190	\$71
Non-cash investing and financing activities		
Issuance of common stock for business combination	\$—	\$3,447
Change in liability for unvested exercised options	\$3	\$28
Equipment and capitalized internal-use software purchased and unpaid at period end	\$2,617	\$1,617
Issuance of common stock for achievement of Glip related matters	\$1,080	\$—
Change in unrealized gain (loss) on available-for-sale securities	\$—	\$190

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Description of Business and Summary of Significant Accounting Policies

Description of Business

RingCentral, Inc. (the Company) is a provider of software-as-a-service (SaaS) solutions for business communications and collaboration. The Company was incorporated in California in 1999 and was reincorporated in Delaware on September 26, 2013.

Basis of Presentation and Consolidation

The unaudited condensed consolidated financial statements and accompanying notes of the Company reflect all adjustments (all of which are normal, recurring in nature and those discussed in these notes) that are, in the opinion of management, necessary for a fair presentation of the interim periods presented. All intercompany balances and transactions have been eliminated in consolidation. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2016. Certain information and note disclosures normally included in annual consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP) have been condensed or omitted under the rules and regulations of the Securities and Exchange Commission (SEC).

The unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported results of operations during the reporting period. The significant estimates made by management affect revenues, accounts receivable, allowance for doubtful accounts, inventory reserves, intangibles, goodwill, share-based compensation, deferred revenue, return reserves, provision for income taxes, uncertain tax positions, loss contingencies, sales tax liabilities, and accrued liabilities. Management periodically evaluates such estimates, which are adjusted prospectively based upon such periodic evaluation. Actual results could differ from these estimates and such differences may be material to the accompanying condensed consolidated financial statements.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The new guidance is a result of a joint project with the International Accounting Standards Board (IASB) to clarify and converge the revenue recognition principles under U.S. GAAP and International Financial Reporting Standards (IFRS) and to develop guidance that would streamline and enhance revenue recognition requirements. In April 2015, the FASB proposed a one-year deferral of the effective

date for the new revenue reporting standard for entities reporting under U.S. GAAP. In accordance with the deferral, ASU 2014-09 will be effective for fiscal 2018, including interim periods within that reporting period, and can be adopted either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption. The Company is currently evaluating the impact that the standard will have on its consolidated financial statements and related disclosures and has not selected an adoption method.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which will require a lessee to recognize assets and liabilities for leases with lease terms of more than twelve months. Both capital and operating leases will need to be recognized on the balance sheet. The standard is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact that the standard will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net). This standard amends ASU 2014-09 to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The effective date and transition of this amendment is the same as the effective date and transition of ASU 2014-09. The Company is currently in the process of evaluating the impact of the adoption on its consolidated financial statements and related disclosures.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation: Improvements to Employee Share-Based Payment Accounting (Topic 718), which simplifies the accounting for stock-based compensation related to the accounting for forfeitures, employer tax withholding, excess tax benefits related to awards and cash flow presentations. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The adoption of this amendment is not expected to have a material impact on the Company's consolidated financial statements or related disclosures.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing (Topic 606), which amends the revenue guidance on identifying performance obligations and accounting for licenses of intellectual property. The effective date and transition of this amendment is the same as the effective date and transition of ASU 2014-09. The Company is currently in the process of evaluating the impact of the adoption on its consolidated financial statements and related disclosures.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which clarifies certain issues related to transitioning to the new revenue guidance, as well as assessing collectability, recognition of noncash consideration, and presentation of sales and other similar taxes in revenue transactions. The effective date and transition of this amendment is the same as the effective date and transition of ASU 2014-09. The Company is currently in the process of evaluating the impact of the adoption on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments, which clarifies the presentation and classification in the statement of cash flows. The guidance addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice for certain cash receipts and cash payments. The standard is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The adoption of this amendment is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

In October 2016, the FASB issued ASU 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, which requires entities to recognize at the transaction date the income tax effects for intra-entity transfers of assets other than inventory. The standard is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is currently in the process of evaluating the impact of the adoption on its consolidated financial statements and related disclosures.

Reclassification

Certain immaterial items previously reported have been reclassified to conform to the current year's reporting presentation.

Note 2. Agency Agreement with Westcon Group

In January 2016, the Company entered into a sales agency agreement with Westcon Group, Inc. (Westcon), a global distributor of communications devices, to provide the phones purchased by customers. Under this agreement, the Company is an agent of Westcon and receives a commission for its services, which primarily include referring phone sales to Westcon. Westcon will provide phones directly to the Company's customers instead of the Company purchasing phones from third-party vendors and reselling the phones to the Company's customers. Commission revenues from the arrangement are recorded as the Company is the agent for these sales based on the following criteria:

- the Company is not the primary obligor in the arrangement and the customer contracts for the sales of phones are entered into with Westcon;
- the Company does not have latitude to establish pricing with customers as the sales agency agreement restricts the prices at which phones may be sold by the Company;
- the Company does not have collection risk for phones sold under this model since it is entitled to a sales commission regardless of whether the customer pays Westcon;
- the Company does not carry inventory and does not have general inventory risk; and
- warranty responsibility and services are provided by Westcon.

The Company completed its transition of direct phone sales to Westcon during the three months ended June 30, 2016. The transition excludes the Company's carriers' phone sales from the agency model. The Company does not plan to transition the carrier partners to the agency model as the billing relationships to these customers are through the carriers.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

The Company's sales of phones that are provided free or significantly discounted to customers are not part of the sales agency agreement with Westcon. The Company recognizes revenues and cost from these sales as the Company is the primary obligor and has latitude in pricing.

Note 3. Change in Presentation

As a result of the new sales agency model, the Company replaced the product revenues line in its consolidated statements of operations with a line called other revenues, which includes the commission revenues earned as an agent of Westcon, product revenues from sales of phones not sold under the sales agency agreement with Westcon, phone sales to carrier partners, phone rentals, and professional implementation services. Correspondingly, costs of other revenues include the costs for all the above items.

For the three and nine months ended September 30, 2016 and 2015, the majority of other revenues were product revenues from sales of phones that fell outside the sales agency agreement with Westcon. Accordingly, to provide a comparison of product revenues and product cost of revenues prior to and subsequent to the change in presentation, product revenues were \$2.2 million and \$6.0 million for the three months ended September 30, 2016 and 2015, respectively, and \$10.0 million and \$16.9 million for the nine months ended September 30, 2016 and 2015, respectively. Product cost of revenues were \$3.4 million and \$5.1 million for the three months ended September 30, 2016 and 2015, respectively, and \$11.6 million and \$14.5 million for the nine months ended September 30, 2016 and 2015, respectively.

Note 4. Financial Statement Components

Cash and cash equivalents consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Cash	\$ 33,045	\$ 18,522
Money market funds	119,345	119,066
Total cash and cash equivalents	\$ 152,390	\$ 137,588

Accounts receivable, net consisted of the following (in thousands):

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	September 30, 2016	December 31, 2015
Accounts receivable	\$ 20,811	\$ 15,509
Unbilled accounts receivable	3,177	4,031
Allowance for doubtful accounts	(405)	(377)
Accounts receivable, net	\$ 23,583	\$ 19,163

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

	September 30, 2016	December 31, 2015
Computer hardware and software	\$ 58,394	\$ 49,774
Internal-use software development costs	9,174	7,432
Furniture and fixtures	4,391	3,610
Leasehold improvements	2,480	2,412
Total property and equipment	74,439	63,228
Less: accumulated depreciation and amortization	(43,300)	(35,068)
Property and equipment, net	\$ 31,139	\$ 28,160

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Accrued liabilities consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Accrued compensation and benefits	\$ 14,937	\$ 10,128
Accrued sales, use and telecom related taxes	7,241	5,243
Accrued marketing	6,385	3,930
Other accrued expenses	17,805	15,401
Total accrued liabilities	\$ 46,368	\$ 34,702

Note 5. Fair Value of Financial Instruments

Fair value is based on the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company measures and reports certain cash equivalents, including money market funds and certificates of deposit, at fair value in accordance with the provisions of the authoritative accounting guidance that addresses fair value measurements. This guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. The hierarchy is broken down into three levels based on the reliability of the inputs as follows:

Level 1: Valuations based on observable inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Valuations based on observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3: Valuations based on unobservable inputs that are supported by little or no market activity and that are based on management's assumptions, including fair value measurements determined by using pricing models, discounted cash flow methodologies or similar techniques.

The financial assets carried at fair value were determined using the following inputs (in thousands):

	Balance at September 30, 2016	(Level 1)	(Level 2)	(Level 3)
Cash equivalents:				
Money market funds	\$ 119,345	\$ 119,345	\$ —	\$ —
Other assets:				
Certificates of deposit	\$ 530	\$ —	\$ 530	\$ —

	Balance			
	at			
	December		(Level	(Level
	31, 2015	(Level 1)	2)	3)
Cash equivalents:				
Money market funds	\$ 119,066	\$ 119,066	\$ —	\$ —
Other assets:				
Certificates of deposit	\$ 530	\$ —	\$ 530	\$ —

The Company's other financial instruments, including accounts receivable, accounts payable, and other current liabilities, are carried at cost, which approximates fair value due to the relatively short maturity of those instruments.

At September 30, 2016 and December 31, 2015, the Company estimated the fair value of its debt using an expected present value technique, which is based on observable market inputs using interest rates currently available to companies of similar credit standing for similar terms and remaining maturities. The estimated fair value of the Company's current and non-current debt obligations was \$15.8 million at September 30, 2016, compared to its carrying amount of \$15.8 million at that date. The estimated fair value of the Company's current and non-current debt obligations was \$19.0 million at December 31, 2015, compared to its carrying amount of \$18.6 million at that date. If the debt was measured at fair value in the condensed consolidated balance sheets, the Company's current and non-current debt would be classified in Level 2 of the fair value hierarchy.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 6. Business Combinations

On June 4, 2015, the Company acquired Glip, Inc. (Glip), a cloud messaging and collaboration company based in Boca Raton, Florida. Glip is a provider of team messaging services, integrated with project management, group calendars, notes, annotations, and file sharing. The consideration for this acquisition, net of cash acquired and including the fair value of contingent consideration payable in cash upon achievement of certain earn out milestones and the fair value of common stock issuable to the former stockholders of Glip was \$11.9 million. Of this total consideration, \$1.5 million of cash was held back by the Company upon closing as security for certain indemnification obligations of such stockholders. In June 2016, the Company paid the \$1.5 million in full.

The initial fair value of the milestone based earn out liability was determined to be \$2.3 million using various estimates, including probabilities of achievement and discount rates. During the three months ended September 30, 2016, the Company issued 45,893 shares of the Company's Class A common stock to settle certain milestones achieved. Based on the completion of milestones for the quarter ended September 30, 2016 and the estimated probability of completing the remaining milestones, the estimated fair value of the milestones based earn out liability was \$1.9 million at September 30, 2016, which is classified as a current liability in the condensed consolidated balance sheets.

Additionally, under the terms of the acquisition, the Company may also pay up to \$2.0 million in payments at the end of a two-year period to certain Glip employees, who continue to be employees of the Company, which are accounted for as a post-combination expense. At September 30, 2016, the contingent payment liability was \$1.2 million and classified as a current liability in the consolidated balance sheets.

The carrying values of intangible assets are as follows (in thousands):

			September 30, 2016		December 31, 2015	
			Acquired		Acquired	
			Accumulated		Accumulated	
			Intangibles,		Intangibles,	
	Estimated Lives	Cost	Amortization	Non	Amortization	Non
Customer relationships	2 years	\$840	\$555	\$ 285	\$240	\$ 600
Developed technology	5 years	3,010	796	2,214	344	2,666
Total acquired intangible assets		\$3,850	\$1,351	\$ 2,499	\$584	\$ 3,266

Amortization expense from acquired intangible assets for the three months ended September 30, 2016 and 2015 was \$0.3 million for both periods. Amortization expense from acquired intangible assets for the nine months ended September 30, 2016 and 2015 was \$0.8 million and \$0.3 million, respectively. Amortization of developed technology is included in cost of revenues and amortization of customer relationships is included in sales and marketing expenses in the condensed consolidated statements of operations. At September 30, 2016, the weighted average amortization

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periods for customer relationship and developed technology approximate 0.7 years and 3.7 years, respectively.

Estimated amortization expense for acquired intangible assets for the following five fiscal years and thereafter is as follows (in thousands):

2016 (remaining)	\$255
2017	782
2018	602
2019	602
2020	258
Total estimated amortization expense	\$2,499

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 7. Debt

As of September 30, 2016, the Company's debt was comprised of borrowings under the Third Amended and Restated Loan and Security Agreement dated March 30, 2015 (SVB Agreement), as amended, with Silicon Valley Bank (SVB). Under the SVB Agreement, the Company has one outstanding growth capital term loan (2013 Term Loan) and a revolving line of credit.

The 2013 Term Loan was borrowed on December 31, 2013 with a principal amount of \$15.0 million, which is being repaid in 48 equal monthly installments of principal, plus accrued and unpaid interest. Interest is due monthly and accrues at a floating rate based on the Company's option of an annual rate of either the (i) prime rate plus a margin of 0.75% or 1.00% or (ii) adjusted LIBOR rate (based on one, two, three or six-month interest periods) plus a margin of 3.75% or 4.00%, in each case such margin being determined based on cash balances maintained with SVB. The Company elected the prime rate option. In May 2016, the terms of the SVB Agreement were amended to reduce the margin on the annual rate of the 2013 Term Loan to either (i) prime rate plus a margin of 0.25% or 0.50% or (ii) adjusted LIBOR rate (based on one, two, three, or six-month interest periods) plus a margin of 3.25% or 3.50%, resulting in a current interest rate of 3.75% based on the prime rate option and cash balance maintained with SVB. As of September 30, 2016, the outstanding principal balance of the 2013 Term Loan was \$5.0 million, of which \$1.3 million is payable subsequent to September 30, 2017 and is classified as a non-current liability in the accompanying condensed consolidated balance sheet.

The revolving line of credit provides for a maximum borrowing of up to \$15.0 million in principal amount, subject to limits based on recurring software subscription revenue amounts as defined in the SVB Agreement. The recurring software subscription revenue requirement is not expected to limit the amount of borrowings available under the line of credit. Under the line of credit, interest is paid monthly and accrues at a floating rate based on the Company's option of an annual rate of either the (i) prime rate plus a margin of 0.25% or 0.50% or (ii) adjusted LIBOR rate (based on one, two, three or six-month interest periods) plus a margin of 3.25% or 3.50%, in each case such margin being determined based on cash balances maintained with SVB. The Company elected the prime rate option. In August 2015, the terms of the SVB Agreement were amended to extend the maturity of the revolving line of credit from August 13, 2015 to August 14, 2017. In May 2016, the terms of the SVB Agreement were amended to reduce the margin on the annual rate of the revolving line of credit to either the (i) prime rate plus a margin of 0% or 0.25% or (ii) adjusted LIBOR rate (based on one, two, three, or six-month interest periods) plus a margin of 3.0% to 3.25%, resulting in a current interest rate of 3.50% based on the prime rate option and cash balance maintained with SVB. As of September 30, 2016, the outstanding principal balance and the available borrowing capacity of the line of credit were \$10.8 million and \$4.2 million, respectively. The outstanding principal balance is classified as a current liability in the condensed consolidated balance sheet as the principal balance is due in August 2017.

The Company has pledged substantially all of its assets, excluding intellectual property, as collateral to secure its obligations under the SVB Agreement. The SVB Agreement contains customary negative covenants that limit the Company's ability to, among other things, incur additional indebtedness, grant liens, make investments, repurchase stock, pay dividends, transfer assets and merge or consolidate. The SVB Agreement, as amended, also contains customary affirmative covenants, as well as financial covenants that require the Company to (i) maintain minimum cash balances of \$10.0 million, as defined in the agreement, and (ii) maintain minimum EBITDA levels, as determined in accordance with the agreement. In March 2015, the Company adjusted certain financial covenants to expand its ability to invest in certain foreign subsidiaries and property and equipment. The Company was in compliance with all covenants under its credit agreement with SVB as of September 30, 2016.

Note 8. Commitments and Contingencies

Leases

The Company leases facilities for office space under non-cancelable operating leases for its U.S. and international locations and has entered into capital lease arrangements to obtain property and equipment for its operations. In addition, the Company leases space from third party datacenter hosting facilities under co-location agreements to support its cloud infrastructure. The Company leases space for its corporate headquarters in Belmont, California through July 2021.

Sales Tax Liability

The Company regularly increases its sales and marketing activities in various states within the U.S., which may create nexus in those states to collect sales taxes on sales to customers. Although the Company is diligent in collecting and remitting such taxes, there is uncertainty as to what constitutes sufficient in state presence for a state to levy taxes, fees, and surcharges for sales made over the Internet. As of September 30, 2016 and December 31, 2015, the Company had a long-term sales tax liability of \$3.5 million and \$3.7 million, respectively, based on its best estimate of the probable liability for the loss contingency incurred as of those dates. The

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Company's estimate of a probable outcome under the loss contingency is based on analysis of its sales and marketing activities, revenues subject to sales tax, and applicable regulations in each state in each period. No significant adjustments to the long-term sales tax liability have been recognized in the accompanying condensed consolidated financial statements for changes to the assumptions underlying the estimate. However, changes in management's assumptions may occur in the future as the Company obtains new information which can result in adjustments to the recorded liability. Increases and decreases to the long-term sales tax liability are recorded as general and administrative expense.

The Company recorded a current sales tax liability for non-contingent amounts expected to be remitted in the next twelve months of \$4.7 million and \$4.4 million as of September 30, 2016 and December 31, 2015, respectively, which is included in accrued liabilities.

Legal Matters

The Company determines whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. The Company assesses its potential liability by analyzing specific litigation and regulatory matters using reasonably available information. The Company develops its views on estimated losses in consultation with inside and outside counsel, which involves a subjective analysis of potential results and outcomes, assuming various combinations of appropriate litigation and settlement strategies. Legal fees are expensed in the period in which they are incurred.

TCPA Matter

On April 21, 2016, Supply Pro Sorbents, LLC (SPS) filed a putative class action against the Company in the United States District Court for the Northern District of California (Court), alleging common law conversion and violations of the federal Telephone Consumer Protection Act (TCPA) arising from fax cover sheets used by the Company's customers when sending facsimile transmissions over the Company's system (Lawsuit). SPS sought statutory damages, costs, attorneys' fees and an injunction in connection with its TCPA claim, and unspecified damages and punitive damages in connection with its conversion claim. On July 6, 2016, the Company filed a Petition for Expedited Declaratory Ruling before the Federal Communications Commission (FCC), requesting that the FCC issue a ruling clarifying certain portions of its regulations promulgated under TCPA at issue in the Lawsuit (Petition). On July 8, 2016, the Company filed a motion to dismiss the Lawsuit in its entirety, along with a collateral motion to dismiss or stay the Lawsuit pending a ruling by the FCC on the Company's Petition. On October 7, 2016, the Court granted the Company's motion to dismiss and gave SPS 20 days to amend its complaint. The Court concurrently dismissed the Company's motion to dismiss or stay as moot. SPS filed its amended complaint on October 27, 2016, alleging the same theories and claims. The Company intends to vigorously defend itself and anticipates filing another motion to dismiss and a collateral motion to dismiss or stay the case pending resolution of the FCC Petition. Litigation is inherently uncertain, however, and it is too early in this proceeding to predict the outcome of this Lawsuit. Based on the information known by the Company as of the date of this filing and the rules and regulations applicable to the preparation of the Company's condensed consolidated financial statements, it is not possible to provide an estimated amount of any such loss or range of loss that may occur.

As of December 31, 2015, there were no significant ongoing legal matters and the Company did not have any accrued liabilities recorded for such loss contingencies.

Note 9. Share-Based Compensation

A summary of share-based compensation expense recognized in the Company's condensed consolidated statements of operations is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenues	\$859	\$535	\$2,324	\$1,468
Research and development	1,996	1,351	5,491	3,745
Sales and marketing	3,023	1,797	7,791	5,333
General and administrative	2,511	2,069	6,997	5,244
Total share-based compensation expense	\$8,389	\$5,752	\$22,603	\$15,790

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

A summary of share-based compensation expense by award type is as follows (in thousands):

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Options	\$2,382	\$2,744	\$7,366	\$8,357
Employee stock purchase plan rights	527	287	1,375	854
Restricted stock units	5,480	2,721	13,862	6,579
Total share-based compensation expense	\$8,389	\$5,752	\$22,603	\$15,790

Equity Incentive Plans

As of September 30, 2016, a total of 8,775,309 shares remained available for grant under the 2013 Equity Incentive Plan (2013 Plan). A summary of option activity under all of the Company's equity incentive plans at September 30, 2016 and changes during the period then ended is presented in the following table:

	Number of Options Outstanding (in thousands)	Weighted- Average Exercise Price Per Share	Weighted- Average Contractual Term (in Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	8,048	\$ 10.27	6.2	\$ 107,091
Granted	539	16.46		
Exercised	(601)	9.07		
Canceled/Forfeited	(236)	15.53		
Outstanding at September 30, 2016	7,750	\$ 10.64	5.5	\$ 101,047
Vested and expected to vest as of September 30, 2016	7,379	\$ 10.37	5.5	\$ 98,134
Exercisable as of September 30, 2016	5,389	\$ 8.53	5.4	\$ 81,557

The weighted average grant date fair value of options granted and the total intrinsic value of options exercised were as follows (in thousands, except weighted average grant date fair value):

Three Months Ended	Nine Months Ended
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	September 30,		September 30,	
	2016	2015	2016	2015
Weighted average grant date fair value per share	\$9.22	\$7.48	\$6.70	\$6.76
Total intrinsic value of options exercised	\$2,561	\$7,135	\$6,956	\$16,964

The Company estimated the fair values of each option awarded on the date of grant using the Black-Scholes-Merton option pricing model, which requires inputs including the fair value of common stock, expected term, expected volatility, risk-free interest rate, and dividend yield. The weighted-average assumptions used in the option pricing model in the periods presented were as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Expected term for employees (in years)	4.7	4.7	4.7	4.8
Expected term for non-employees (in years)	5.8	7.2	6.1	7.1
Risk-free interest rate	1.1 %	1.5 %	1.1 %	1.2 %
Expected volatility	46.4 %	47.0 %	47.2 %	48.0 %
Expected dividend yield	0 %	0 %	0 %	0 %

As of September 30, 2016, there was approximately \$12.7 million of unrecognized share-based compensation expense, net of estimated forfeitures, related to non-vested stock option grants, which will be recognized on a straight-line basis over the remaining weighted-average vesting period of approximately 2.2 years.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Employee Stock Purchase Plan

The 2013 Employee Stock Purchase Plan (ESPP) allows eligible employees to purchase shares of the Class A common stock at a discounted price, through payroll deductions of up to the lesser of 15% of their eligible compensation or the IRS allowable limit per calendar year. A participant may purchase a maximum of 3,000 shares during an offering period. The offering periods start on the first trading day on or after May 11th and November 11th of each year. At the end of the offering period, the discounted purchase price is set at the lower of: (i) 90% of the fair value of the Company's Class A common stock at the beginning of the six month offering period and (ii) 90% of the fair value of the Company's Class A common stock at the end of the six month offering period.

As of September 30, 2016, there was a total of \$0.2 million of unrecognized share-based compensation expense, net of estimated forfeitures, related to ESPP, which will be recognized on a straight-line basis over the remaining weighted-average vesting period of approximately 0.1 years. At September 30, 2016, a total of 2,450,266 shares were available for issuance under the ESPP.

Restricted Stock Units

The 2013 Plan provides for the issuance of restricted stock units (RSUs) to employees, directors, and consultants. RSUs issued under the 2013 Plan generally vest and are released over four years. A summary of activity of RSUs under the 2013 Plan at September 30, 2016 and changes during the period then ended is presented in the following table:

	Number of RSUs Outstanding (in thousands)	Weighted- Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	2,288	\$ 16.63	\$ 53,972
Granted	2,597	18.48	
Released	(803)	16.59	
Canceled/Forfeited	(326)	17.69	
Outstanding at September 30, 2016	3,756	\$ 17.82	\$ 89,068

As of September 30, 2016, there was a total of \$49.1 million of unrecognized share-based compensation expense, net of estimated forfeitures, related to restricted stock units, which will be recognized on a straight-line basis over the remaining weighted-average vesting period of approximately 3.0 years.

Note 10. Segment Reporting

The Company has determined the chief executive officer is the chief operating decision maker. The Company's chief executive officer reviews financial information presented on a consolidated basis for purposes of assessing performance and making decisions on how to allocate resources. Accordingly, the Company has determined that it operates in a single reporting segment.

Concentrations

Revenue by geographic location is based on the billing address of the customer. More than 90% of the Company's revenues were derived from the U.S. during the three and nine months ended September 30, 2016 and 2015.

Generally, 77% of the Company's billings, including carrier partner billings, are collected through credit card payments, resulting in a minimal accounts receivable balance. The Company's accounts receivable balance primarily consists of receivables due from larger customers and carriers who are billed on invoices at customary payment terms. As the Company moves up-market and acquires larger customers, the Company expects the accounts receivable balance to increase. At September 30, 2016 and December 31, 2015, one of the Company's carriers accounted for 37% and 39% of the Company's total accounts receivable, respectively.

Long-lived assets by geographic location is based on the location of the legal entity that owns the asset. At September 30, 2016 and December 31, 2015, more than 89% of the Company's consolidated long-lived assets were located in the U.S. with no single country outside of the U. S. representing more than 10% of the Company's consolidated long-lived assets.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 11. Income Taxes

The provision for income taxes for the three and nine months ended September 30, 2016, was \$46,000 and \$153,000, respectively, and consisted primarily of state minimum taxes and foreign income taxes. For the three and nine months ended September 30, 2015, the Company recorded a benefit for income taxes of \$56,000 and \$1.3 million, respectively, which was due to partially releasing its valuation allowance. During June 2015, the Company recorded a deferred tax liability for the book-tax basis difference for the intangibles acquired as part of the Glip acquisition. As this deferred tax liability provided an additional source of income to support the realizability of the Company's pre-existing deferred tax asset, the Company released \$1.4 million of its valuation allowance in June 2015.

For the three and nine months ended September 30, 2016 and September 30, 2015, the provision for income taxes differed from the U.S federal statutory rate primarily due to state and foreign taxes currently payable. Additionally, the Company realized no benefit for current year losses due to a full valuation allowance against the U.S. and the foreign net deferred tax assets.

The realization of tax benefits of net deferred tax assets is dependent upon future levels of taxable income, of an appropriate character, in the periods the items are expected to be deductible or taxable. Based on the available objective evidence, the Company does not believe it is more likely than not that the net deferred tax assets will be realizable. Accordingly, the Company has provided a full valuation allowance against the entire domestic and the majority of the foreign net deferred tax assets as of September 30, 2016 and December 31, 2015. The Company intends to maintain the full valuation allowance on the U.S. net deferred tax assets until sufficient positive evidence exists to support a reversal of, or decrease in, the valuation allowance.

During the three and nine months ended September 30, 2016, there have been no significant changes to the total amount of unrecognized tax benefits.

Note 12. Basic and Diluted Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested shares of common stock subject to repurchase or forfeiture as they are not deemed to be issued for accounting purposes. Diluted net loss per share is computed by giving effect to all potential shares of common stock, stock options, restricted stock units, ESPP, stock options related to the non-vested early exercises, and stock related to non-vested restricted stock awards, to the extent they are dilutive. For the three and nine months ended September 30, 2016 and 2015, all such common stock equivalents have been excluded from diluted net loss per share as the effect to net loss per share would be anti-dilutive.

The following table sets forth the computation of the Company's basic and diluted net loss per share of common stock (in thousands, except per share data):

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator				
Net loss	\$(7,979)	\$(6,336)	\$(22,363)	\$(25,158)
Denominator				
Weighted-average common shares for basic and diluted net loss				
per share	73,285	70,580	72,669	69,614
Basic and diluted net loss per share	\$(0.11)	\$(0.09)	\$(0.31)	\$(0.36)

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

The following table presents the weighted-average potential shares that were excluded from the computation of weighted-average common shares in computing the diluted net loss per common share for the periods presented because including them would have had an anti-dilutive effect (in thousands):

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2016	
	2016	2015	2016	2015
Shares of unvested common stock subject to repurchase	—	5	—	5
Shares of common stock issuable under equity incentive awards				
outstanding	11,990	11,519	11,784	11,598
Potential common shares excluded from diluted net loss per share	11,990	11,524	11,784	11,603

Note 13. Related Party Transactions

In the ordinary course of business, the Company made purchases from Alphabet Inc., the parent company of Google Inc., at which one of the Company's directors serves as a Vice President of Google, Inc. Total payables to Alphabet at September 30, 2016 and December 31, 2015 were \$1.5 million and \$2.0 million, respectively. Total expenses incurred from Alphabet were \$3.8 million and \$9.8 million in the three and nine months ended September 30, 2016, respectively, and \$2.8 million and \$8.9 million for the three and nine months ended September 30, 2015, respectively.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K filed with the SEC on February 29, 2016 under the Securities Act of 1934, as amended (the Securities Act). As discussed in the section titled "Special Note Regarding Forward-Looking Statements," the following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ significantly from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included under Part II, Item 1A below.

Overview

We are a leading provider of software-as-a-service, or SaaS, solutions for the way employees communicate and collaborate in business. We believe that our innovative, cloud-based approach disrupts the large market for business communications and collaboration by providing flexible and cost-effective solutions that support distributed workforces, mobile employees, and the proliferation of smart phones and tablets. We enable convenient and effective communications for our customers, across all their locations, all their employees, all the time, thus enabling a more productive and dynamic workforce.

We primarily generate revenues by selling software subscriptions of our RingCentral Office, RingCentral Professional, RingCentral Fax, RingCentral Contact Center, and RingCentral Glip offerings. RingCentral Office, which offers an integrated communications and collaboration solution, is offered at monthly subscription rates, varying by the specific functionalities and services and the number of users. We recently introduced RingCentral Global Office (Global Office) as an expansion of RingCentral Office. Global Office, offered on a monthly subscription, connects workforces across multiple countries, while reducing complexity and high costs of maintaining multiple, legacy on-premise PBX systems with a single cloud solution. RingCentral Professional is inbound call management for mobile professionals offered at monthly subscription rates that vary based on the desired amount of minutes usage and extensions allotted to the plan. RingCentral Fax is offered at monthly subscription rates that vary based on the desired number of pages and phone numbers allotted to the plan. RingCentral Contact Center is a multi-channel hosted contact center solution that integrates with RingCentral Office, offered at a monthly subscription based on three editions with varying features and capabilities. Recently, RingCentral introduced Rooms and Rooms Connector to bring a cloud web conferencing solution to meeting rooms for a monthly per license add-on fee. We also offer RingCentral Connect Platform, which is an open platform supported by Application Program Interfaces (APIs) and Software Development Kits (SDKs) that allows developers to integrate our solution with leading business applications or to customize within their own business workflows. RingCentral Glip is a team messaging and collaboration tool that is made available as a feature to all RingCentral Office customers, and as a freemium offering to non-RingCentral users. Seamlessly integrated with RingCentral Office, RingCentral Glip enables greater work productivity and team engagement, and is among the first team messaging tools to integrate a complete Unified Communication as a Service (UCaaS) suite. RingCentral CloudConnect is a service that allows enterprises to leverage their dedicated and private connections to exchange data directly with the RingCentral cloud. Customers use their preferred network service provider to connect to the RingCentral cloud through a private data exchange enabling lower latency, greater network reliability and availability, and added security.

Our subscription plans have historically had monthly or annual contractual terms, although we also have subscription plans with multi-year contractual terms, generally with larger customers. We believe that this flexibility in contract duration is important to meet the different needs of our customers. Generally, most of our fees for subscription plans have been billed in advance via credit card. However, as the size of RingCentral Office customer accounts grow, we

expect to bill more customers through commercial invoices with customary payment terms and, accordingly, our levels of accounts receivable may increase. We also expect our level of prepayments by larger customers with annual or multi-year contracts to increase and, accordingly, our level of deferred revenue may increase. For the three and nine months ended September 30, 2016 and 2015, software subscriptions revenues accounted for more than 90% of our total revenues. The remainder of our revenues has historically been primarily comprised of product revenues from the sale of pre-configured office phones. We do not develop, manufacture, or otherwise touch the delivery of physical phones and offer it as a convenience for a total solution to our customers in connection with subscriptions to our services.

In January 2016, we entered into a sales agency agreement with Westcon Group, Inc. (Westcon), a global distributor of communications devices, to provide the phones purchased by customers. Under this agreement, we are an agent and receive a commission for our services, which primarily include referring sales to Westcon. Westcon provides phones directly to our customers instead of us purchasing phones from third-party vendors and reselling the phones to our customers. We record commission revenues for this arrangement because we are the agent for these sales. We completed our transition of direct phone sales to Westcon during the three months ended June 30, 2016. The transition excludes our carriers' phone sales from the agency model. We do not plan to transition the carrier partners to the agency model as the billing relationships to these customers are through the carriers. In addition, we will at times have sales in which we will provide free or significantly discounted phones to our customers for promotional reasons. As our agency arrangement does not allow for these significant discounts, we will be the seller to these customers and recognize the related revenues and costs from the sale. We expect the shift to the new agency model to result in the reduction of our other revenues and the corresponding cost of other revenues, resulting in improved margins.

We make significant upfront investments to acquire customers. Until 2010, we acquired most of our customer subscriptions through direct transactions on our website driven by online marketing channels. Beginning in 2010, in connection with our introduction of RingCentral Office, we established a direct, inside sales force. Since then, we have continued investing in our direct, inside sales force while also developing indirect sales channels to market our brand and our subscription offerings. Our indirect sales channel consists of a network of over 3,000 sales agents and resellers, including distributors such as Ingram Micro Inc., Tech Data Corporation, and Jenne Inc., as well as carrier partners including AT&T Inc., TELUS Communications Company, and BT Group plc, which we refer to collectively as resellers. We intend to continue to foster this network and expand our network with other resellers. We also participate in more traditional forms of media advertising, such as radio and billboard advertising.

Since its launch, our revenue growth has primarily been driven by our flagship RingCentral Office product offering, which has resulted in an increased number of customers, increased average software subscription revenue per customer, and increased retention of our existing customer and user base. We define a "customer" as one individual billing relationship for the subscription to our services, which generally correlates to one company account per customer. In the case of our carrier partners, who resell our product to multiple companies, we consider each reseller to be a single customer. We define a user as one person within a customer who has been granted a subscription license to use our services, such that the number of end-users per customer generally correlates closely to the number of employees within a customer account. As of September 30, 2016, we had customers from a range of industries including advertising, financial services, healthcare, legal services, non-profit organizations, real estate, retail, technology, insurance, education, waste management, construction, security services, restaurant, and software. In October of 2013, we launched our United Kingdom (U.K.) operations; however, for the three and nine months ended September 30, 2016 and 2015, the vast majority of our total revenues were generated in the U.S. and Canada, although we expect the percentage of our total revenues derived outside of the U.S. and Canada to grow as we expand internationally in the U.K. and beyond.

The growth of our business and our future success depend on many factors, including our ability to expand our customer base to medium-sized and larger customers, continue to innovate, grow revenues from our existing customer base, expand our distribution channels and scale internationally.

While these areas represent significant opportunities for us, they also pose risks and challenges that we must address in order to sustain the growth of our business and improve our operating results. We have experienced significant growth in recent periods, with total revenues of \$296.2 million, \$219.9 million, and \$160.5 million in fiscal years ended December 31, 2015, 2014 and 2013, respectively, generating year-over-year increases of 35% and 37%, respectively. For the nine months ended September 30, 2016 and 2015, our total revenues were \$275.2 million and \$212.8 million, respectively, representing a year-over-year increase of 29%. We have continued to make significant expenditures and investments, including those in sales and marketing, research and development, infrastructure and

operations and incurred net losses of \$32.1 million, \$48.3 million, and \$46.1 million in the fiscal years ended December 31, 2015, 2014 and 2013, respectively. For the nine months ended September 30, 2016 and 2015, our net loss was \$22.4 million and \$25.2 million, respectively.

Key Business Metrics

In addition to generally accepted accounting principles, or U.S. GAAP, and financial measures such as total revenues, gross margin and cash flows from operations, we regularly review a number of key business metrics to evaluate growth trends, measure our performance, and make strategic decisions. We discuss revenues and gross margin under “Results of Operations” and cash flow from operations under “Liquidity and Capital Resources.” Other key business metrics are discussed below.

Annualized Exit Monthly Recurring Subscriptions

We believe that our Annualized Exit Monthly Recurring Subscriptions (ARR) is a leading indicator of our anticipated software subscriptions revenues. We believe that trends in revenue are important to understanding the overall health of our business, and we use these trends in order to formulate financial projections and make strategic business decisions. Our Annualized Exit Monthly Recurring Subscriptions equals our Monthly Recurring Subscriptions multiplied by 12. Our Monthly Recurring Subscriptions equals the monthly value of all customer subscriptions in effect at the end of a given month. For example, our Monthly Recurring Subscriptions at September 30, 2016 was \$32.5 million. As such, our Annualized Exit Monthly Recurring Subscriptions at September 30, 2016 was \$389.5 million.

RingCentral Office Annualized Exit Monthly Recurring Subscriptions

We calculate our RingCentral Office Annualized Exit Monthly Recurring Subscriptions (Office ARR) in the same manner as we calculate our Annualized Exit Monthly Recurring Subscriptions, except that only customer subscriptions from RingCentral Office customers are included when determining Monthly Recurring Subscriptions for the purposes of calculating this key business metric. RingCentral Office is our flagship product offering. We believe that trends in revenue with respect to RingCentral Office are also important to understanding the overall health of our business, and we use these trends in order to formulate financial projections and make strategic business decisions. Our RingCentral Office Annualized Exit Monthly Recurring Subscriptions at September 30, 2016 was \$316.8 million.

Net Monthly Subscription Dollar Retention Rate

We believe that our Net Monthly Subscription Dollar Retention Rate provides insight into our ability to retain and grow software subscriptions revenues, as well as our customers' potential long-term value to us. We believe that our ability to retain our customers and expand their use of our solutions over time is a leading indicator of the stability of our revenue base and we use these trends in order to formulate financial projections and make strategic business decisions. We define our Net Monthly Subscription Dollar Retention Rate as (i) one plus (ii) the quotient of Dollar Net Change divided by Average Dollar Monthly Recurring Subscriptions.

We define Dollar Net Change as the quotient of (i) the difference of our Monthly Recurring Subscriptions at the end of a period minus our Monthly Recurring Subscriptions at the beginning of a period minus our Monthly Recurring Subscriptions at the end of the period from new customers we added during the period, (ii) all divided by the number of months in the period. We define our Average Monthly Recurring Subscriptions as the average of the Monthly Recurring Subscriptions at the beginning and end of the measurement period.

For example, if our Monthly Recurring Subscriptions were \$118 at the end of a quarterly period and \$100 at the beginning of the period, and \$20 at the end of the period from new customers we added during the period, then the Dollar Net Change would be equal to (\$0.67), or the amount equal to the difference of \$118 minus \$100 minus \$20, all divided by three months. Our Average Monthly Recurring Subscriptions would equal \$109, or the sum of \$100 plus \$118, divided by two. Our Net Monthly Subscription Dollar Retention Rate would then equal 99.4%, or approximately 99%, or one plus the quotient of the Dollar Net Change divided by the Average Monthly Recurring Subscriptions.

Our key business metrics for the five quarterly periods ended September 30, 2016 were as follows (dollars in millions):

March 31,

September 30,

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	September 30, 2016	June 30, 2016	2016	December 31, 2015	2015
Net Monthly Subscription Dollar Retention Rate	>99%	>99%	>99%	>99%	>99%
Annualized Exit Monthly Recurring Subscriptions	\$ 389.5	\$364.0	\$ 340.3	\$ 317.4	\$ 297.5
RingCentral Office Annualized Exit Monthly Recurring Subscriptions	\$ 316.8	\$291.9	\$ 269.3	\$ 247.4	\$ 227.7

Quarterly Revenue Trends

Our subscriptions revenues are primarily driven by recurring software subscription services. Historically, we have acquired more new customers in the first and third quarters of our fiscal year. However, we have seen this trend become less pronounced as our business has grown, as sales of RingCentral Office have accounted for a higher percentage of our total revenues, and as we move up-market to target and acquire larger customers.

Quarterly Operating Expenses Trends

Operating expenses are primarily driven by employee-related expenses and by sales and marketing programs, and have been relatively consistent as a percentage of revenues. We experience some seasonality in spending on sales and marketing as a percentage of total revenues as we spend relatively less on marketing programs in the third and fourth quarters due to the summer and year-end holiday periods. However, this trend may not continue as we acquire larger customers.

Results of Operations

The following tables set forth selected condensed consolidated statements of operations data and such data as a percentage of total revenues. The historical results presented below are not necessarily indicative of the results that may be expected for any future period (in thousands):

	Three Months		Nine Months Ended	
	Ended		September 30,	September 30,
	2016	2015	2016	2015
Revenues				
Software subscriptions	\$91,853	\$70,321	\$257,898	\$194,713
Other	4,986	6,459	17,323	18,076
Total revenues	96,839	76,780	275,221	212,789
Cost of revenues				
Software subscriptions	19,211	17,084	54,107	49,503
Other	4,244	5,249	13,452	14,906
Total cost of revenues	23,455	22,333	67,559	64,409
Gross profit	73,384	54,447	207,662	148,380
Operating expenses				
Research and development	16,490	13,475	48,097	37,612
Sales and marketing	50,306	34,878	137,796	101,473
General and administrative	13,649	11,922	41,114	34,231
Total operating expenses	80,445	60,275	227,007	173,316
Loss from operations	(7,061)	(5,828)	(19,345)	(24,936)
Other income (expense), net				
Interest expense	(176)	(245)	(585)	(927)
Other income (expense), net	(696)	(319)	(2,280)	(637)
Other income (expense), net	(872)	(564)	(2,865)	(1,564)
Loss before provision (benefit) for income taxes	(7,933)	(6,392)	(22,210)	(26,500)
Provision (benefit) for income taxes	46	(56)	153	(1,342)
Net loss	\$(7,979)	\$(6,336)	\$(22,363)	\$(25,158)

Percentage of Total Revenues

	Three Months Ended September 30, 2016		2015		Nine Months Ended September 30, 2016		2015	
Revenues								
Software subscriptions	95	%	92	%	94	%	92	%
Other	5		8		6		8	
Total revenues	100		100		100		100	
Cost of revenues								
Software subscriptions	20		22		20		23	
Other	4		7		5		7	
Total cost of revenues	24		29		25		30	
Gross profit	76		71		75		70	
Operating expenses								
Research and development	17		18		17		18	
Sales and marketing	52		45		50		48	
General and administrative	14		16		15		16	
Total operating expenses	83		79		82		82	
Loss from operations	(7)	)	(8)	)	(7)	)	(12))
Other income (expense), net								
Interest expense	—		—		—		—	
Other income (expense), net	(1)	)	—		(1))	—	
Other income (expense), net	(1)	)	—		(1))	—	
Loss before provision (benefit) for income taxes	(8)	)	(8)	)	(8)	)	(12))
Provision (benefit) for income taxes	—		—		—		(1))
Net loss	(8)	)%	(8)	)%	(8)	)%	(11))%

Comparison of the three and nine months ended September 30, 2016 and 2015

Revenues

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change
Revenues								
Software subscriptions	\$91,853	\$70,321	\$21,532	31 %	\$257,898	\$194,713	\$63,185	32 %
Other	4,986	6,459	(1,473)	(23)%	17,323	18,076	(753)	(4)%
Total revenues	\$96,839	\$76,780	\$20,059	26 %	\$275,221	\$212,789	\$62,432	29 %
Percentage of revenues								
Software subscriptions	95	%	92	%	94	%	92	%

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Other	5		8			6		8	
Total	100	%	100	%		100	%	100	%

Software subscriptions revenues. Software subscriptions revenues increased by \$21.5 million, or 31%, and \$63.2 million, or 32%, for the three and nine months ended September 30, 2016, respectively, as compared to the respective periods of the prior year primarily due to the acquisition of new customers and an increase in the number of users within our existing customer base. In addition, our software subscriptions revenues mix contained a higher proportion of RingCentral Office customers for the three and nine months ended September 30, 2016 as compared to the respective periods of the prior year, which generally carry a higher monthly subscription rate versus our other product offerings. While the acquisition of new customers and the increase in the number of users within our existing customer base were the primary reasons for the increase, the short-term trends for user and customer acquisition have varied from period to period as some customers made a small initial user subscription followed by a larger additional user subscription, while other customers purchased a large initial user subscription followed by a smaller additional user subscription. In addition, the period of time between a customer's initial subscription and the purchase of additional subscriptions varies significantly, ranging from one month to a few years. The overall growth in our customer base was primarily driven by increased brand awareness of our products, driven by increases in our sales and marketing expenditures of 44% and 36% for the three and nine months ended September 30, 2016 as compared to the respective periods of the prior year, respectively, which include advertising and sales personnel expenditures that helped facilitate the increase in customer acceptance of our products.

Other revenues. In the nine months ended September 30, 2016, we transitioned to a new distribution partner for delivering phones to our customers. Under the agreement, we are an agent and receive a commission for our services, which primarily consists of referring sales to the distribution partner. We completed our transition of direct phone sales to Westcon during the three months ended June 30, 2016. The transition excludes our carriers' phone sales from the agency model. We do not plan to transition our carrier partners to the agency model as the billing relationships to these customers are through the carriers. Under the agency arrangement, we may have sales in which we provide free or significantly discounted phones to our customers for promotional reasons. As our agency arrangement does not allow for these significant discounts, we will be the seller to these customers and recognize the related revenues and costs from the sale. We continued to generate revenues from phone sales during the nine months ended September 30, 2016, from transactions with our carrier partners as they will not be transitioned to the new agency arrangement.

The remainder of our revenues has historically been primarily comprised of product revenues from the sale of pre-configured office phones. We have since replaced the "product revenues" line item in our consolidated statements of operations with a line item for "other" revenues, which includes commissions earned on sales of phones from our distribution partner, phone rentals, professional services, and sales of phones not sold under the sales agency agreement. Other revenues decreased by \$1.5 million, or 23%, and \$0.8 million, or 4%, for the three and nine months ended September 30, 2016, respectively, as compared to the respective periods of the prior year primarily due to the shift to the new agency model during the second quarter of 2016 and the elimination of the majority of our revenues from the sale of phones.

Cost of Revenues and Gross Margin

(in thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,				
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change	
Cost of revenues									
Software subscriptions	\$19,211	\$17,084	\$2,127	12 %	\$54,107	\$49,503	\$4,604	9 %	
Other	4,244	5,249	(1,005)	(19)%	13,452	14,906	(1,454)	(10)%	
Total cost of revenues	\$23,455	\$22,333	\$1,122	5 %	\$67,559	\$64,409	\$3,150	5 %	
Gross margins									
Software subscriptions	79	% 76	%		79	% 75	%		
Other	15	% 19	%		22	% 18	%		
Gross margin %									