PROOFPOINT INC
Form 10-Q
August 02, 2018
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 June 30, 2018

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 001-35506

PROOFPOINT, INC.

(Exact name of Registrant as specified in its charter)

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

(408) 517-4710

(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES 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, or a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth 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
		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

Shares of Proofpoint, Inc. common stock, $0.0001 par value per share, outstanding as of July 20, 2018: 51,272,010 shares.

Table of Contents

TABLE OF CONTENTS

2

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

Proofpoint, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except per share amounts)

(Unaudited)

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 114,225	$ 286,072
Short-term investments	19,832	45,526
Accounts receivable, net	140,644	107,696
Inventory	400	730
Deferred product costs	1,727	1,541
Deferred commissions	29,711	26,249
Prepaid expenses and other current assets	22,349	18,669
Total current assets	328,888	486,483
Property and equipment, net	75,941	73,617
Long-term deferred product costs	326	259
Goodwill	460,592	297,704
Intangible assets, net	158,355	95,602
Long-term deferred commissions	53,712	51,954
Other assets	6,088	12,813
Total assets	$ 1,083,902	$ 1,018,432
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 17,229	$ 12,271
Accrued liabilities	62,404	65,503
Capital lease obligations	35	34
Deferred rent	799	586
Deferred revenue	426,090	364,521
Total current liabilities	506,557	442,915
Convertible senior notes	204,011	197,858
Long-term capital lease obligations	38	55
Long-term deferred rent	3,950	4,102
Other long-term liabilities	7,162	11,069
Long-term deferred revenue	65,147	63,318
Total liabilities	786,865	719,317

Commitments and contingencies (Note 6)		
Stockholders’ equity:		
Convertible preferred stock, $0.0001 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value; 200,000 shares authorized; 51,189 and 50,325 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	5	5
Additional paid-in capital	835,156	787,572
Accumulated other comprehensive loss	(1)	(9)
Accumulated deficit	(538,123)	(488,453)
Total stockholders’ equity	297,037	299,115
Total liabilities and stockholders’ equity	$1,083,902	$1,018,432

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

Proofpoint, Inc.

Condensed Consolidated Statements of Operations

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue:				
Subscription	$169,019	$118,703	$327,806	$231,794
Hardware and services	2,856	3,738	6,530	6,282
Total revenue	171,875	122,441	334,336	238,076
Cost of revenue:(1)(2)				
Subscription	45,618	30,363	87,816	58,684
Hardware and services	5,154	4,130	10,013	8,185
Total cost of revenue	50,772	34,493	97,829	66,869
Gross profit	121,103	87,948	236,507	171,207
Operating expense:(1)(2)				
Research and development	47,527	32,306	91,259	61,912
Sales and marketing	84,911	60,126	162,808	116,046
General and administrative	19,029	12,348	36,554	22,835
Total operating expense	151,467	104,780	290,621	200,793
Operating loss	(30,364)	(16,832)	(54,114)	(29,586)
Interest expense	(3,187)	(5,848)	(6,008)	(11,814)
Other (expense) income, net	(633)	184	(290)	55
Loss before income taxes	(34,184)	(22,496)	(60,412)	(41,345)
(Provision for) benefit from income taxes	(114)	(999)	13,958	(2,433)
Net loss	$(34,298)	$(23,495)	$(46,454)	$(43,778)
Net loss per share, basic and diluted	$(0.67)	$(0.54)	$(0.92)	$(1.00)
Weighted average shares outstanding, basic and diluted	50,935	43,890	50,721	43,562

(1) Includes stock-based compensation expense as follows:				
Cost of subscription revenue	$3,448	$2,863	$6,899	$5,239
Cost of hardware and services revenue	$571	$469	$1,162	$908
Research and development	$9,986	$7,744	$20,021	$14,794
Sales and marketing	$12,382	$8,230	$23,884	$16,127
General and administrative	$7,410	$5,198	$12,903	$9,810

(2) Includes intangible amortization expense as follows:				
Cost of subscription revenue	$7,244	$3,189	$13,020	$6,377

Research and development	$15	$15	$30	$30
Sales and marketing	$3,982	$949	$6,397	$1,916

See accompanying Notes to the Condensed Consolidated Financial Statements.

4

Table of Contents

Proofpoint, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net loss	$(34,298)	$(23,495)	$(46,454)	$(43,778)
Other comprehensive income, net of tax:				
Unrealized gain on short-term investments, net	1	—	8	4
Comprehensive loss	$(34,297)	$(23,495)	$(46,446)	$(43,774)

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

Proofpoint, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities		
Net loss	$(46,454)	$(43,778)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	34,878	19,147
Stock-based compensation	64,869	46,878
Change in fair value of contingent consideration	(79)	(1,730)
Amortization of debt issuance costs and accretion of debt discount	6,153	10,888
Amortization of deferred commissions	16,708	13,275
Deferred income taxes	(14,896)	(1,974)
Other	820	139
Changes in assets and liabilities:		
Accounts receivable	(23,025)	(2,746)
Inventory	330	101
Deferred product costs	(253)	359
Deferred commissions	(21,929)	(17,623)
Prepaid expenses	(2,614)	(1,686)
Other current assets	1,657	260
Long-term assets	350	(3,710)
Accounts payable	4,210	(1,374)
Accrued liabilities	(4,498)	4,565
Deferred rent	61	824
Deferred revenue	48,698	45,140
Net cash provided by operating activities	64,986	66,955
Cash flows from investing activities		
Proceeds from maturities of short-term investments	37,432	56,081
Proceeds from sales for short-term investments	11,931	—
Purchase of short-term investments	(23,694)	(41,360)
Purchase of property and equipment	(16,611)	(22,867)
Receipt from escrow account	555	4,620
Acquisition of business, net of cash acquired	(223,786)	—
Net cash used in investing activities	(214,173)	(3,526)
Cash flows from financing activities		
Proceeds from issuance of common stock	13,001	13,218
Withholding taxes related to restricted stock net share settlement	(34,640)	(25,122)

Repayments of equipment loans and capital lease obligations	(16)	(16)
Contingent consideration payment	(555)	(4,620)
Net cash used in financing activities	(22,210)	(16,540)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(213)	575
Net (decrease) increase in cash, cash equivalents and restricted cash	(171,610)	47,464
Cash, cash equivalents and restricted cash		
Beginning of period	286,660	345,537
End of period	$115,050	$393,001
Supplemental disclosure of noncash investing and financing information		
Unpaid purchases of property and equipment and asset retirement obligations	$3,850	$6,275
Liability awards converted to equity	$8,870	$8,307

6

Table of Contents

	June 30, 2018	June 30, 2017
Reconciliation of cash, cash equivalents and restricted cash as shown in the consolidated statement of cash flows		
Cash and cash equivalents	$114,225	$392,886
Restricted cash included in prepaid expenses and other current assets	337	83
Restricted cash included in other non-current assets	488	32
Total cash, cash equivalents and restricted cash	$115,050	$393,001

See accompanying Notes to the Condensed Consolidated Financial Statements.

Proofpoint, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Dollars and share amounts in thousands, except per share amounts)

1. The Company and Summary of Significant Accounting Policies

The Company

Proofpoint, Inc. (the "Company") was incorporated in Delaware in June 2002 and is headquartered in California.

Proofpoint, Inc. is a leading security-as-a-service provider that enables large and mid-sized organizations worldwide to defend, protect, archive and govern their most sensitive data. The Company's security-and compliance platform is comprised of an integrated suite of threat protection, information protection, and brand protection solutions, including email protection, advanced threat protection, email authentication, data loss prevention, SaaS application protection, response orchestration and automation, digital risk, web browser isolation, email encryption, archiving, eDiscovery, supervision, secure communication, phishing simulation and security awareness computer-based training.

Basis of Presentation and Consolidation

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

These condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("GAAP"), pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and note disclosures have been condensed or omitted pursuant to such rules and regulations. The accompanying Condensed Consolidated Balance Sheet as of December 31, 2017 is derived from audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair statement of the periods presented. Certain prior period amounts have been adjusted due to the adoption of Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers: Topic 606 ("ASC 606"). Refer to Note 2 "Revenue, Deferred Revenue and Deferred Contract Costs" for more information. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results to be expected for the year ending December 31, 2018 or for other interim periods or for future years.

These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes for the year ended December 31, 2017 included in the Company's Annual Report on Form 10-K filed with the SEC. The Company's significant accounting policies are described in Note 1 to those audited consolidated financial statements. See Note 2 "Revenue, Deferred Revenue and Deferred Contract Costs" for the summary of the new accounting policies under ASC 606.

Use of Estimates

The preparation of financial statements in conformity with 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 financial statements, and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates and such difference may be material to the financial statements.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price of the acquired enterprise over the fair value of identifiable assets acquired and liabilities assumed. The Company performs an annual goodwill impairment test during the fourth quarter of a calendar year and more frequently if an event or circumstances indicates that impairment may have occurred. For the purposes of impairment testing, the Company has determined that it has one operating segment and one reporting unit. The Company performs a two-step impairment test of goodwill whereby the fair value of the reporting unit is compared to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not considered impaired and further testing is not required. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then impairment loss equal to the difference is recorded. The identification and measurement of goodwill impairment involves the estimation of the fair value of the Company. The estimate of fair value of the Company, based on the best information available as of the date of the assessment, is subjective and requires judgment, including management assumptions about expected future revenue forecasts and discount rates, changes in the overall economy, trends in the stock price and other factors. No impairment indicators were identified by the Company as of June 30, 2018.

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

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

	Low	High
Patents	4	5
Developed technology	3	7
Customer relationships	2	8
Order backlog	1	3
Trade names and trademarks	1	5

Comprehensive Loss

Comprehensive loss includes all changes in equity that are not the result of transactions with stockholders. The Company's comprehensive loss consists of its net loss and changes in unrealized gains (losses) from its available-for-sale investments. The Company had no material reclassifications out of accumulated other comprehensive loss into net loss for the three and six months ended June 30, 2018 and 2017.

Accounting Pronouncements Adopted in 2018

In May 2014, the FASB issued ASC 606 to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The standard contains a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of services or products to a customer at an amount that reflects the consideration expected to be received in exchange for those services or products. The FASB has issued several amendments to the standard, including clarifications on disclosure of prior-period and remaining performance obligations. The Company adopted ASC 606 effective January 1, 2018 using full retrospective transition method. Refer to Note 2 "Revenue, Deferred Revenue and Deferred Contract Costs" for more information.

In October 2016, FASB issued ASU No. 2016-16, Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"). ASU 2016-16 eliminates the requirement to defer the recognition of current and deferred income taxes for intra-entity asset transfer until the asset has been sold to an outside party. Therefore, an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 has been applied on a modified retrospective basis starting January 1, 2018. As a result of the adoption, the Company’s long-term assets decreased and accumulated deficit increased by $3,216 as of January 1, 2018, the date of adoption.

In August 2016, FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 clarifies how certain cash receipts and payments should be classified in the statement of cash flows, including the potential cash settlement of the Company's convertible senior notes. If the Company elects to cash settle its convertible senior notes (see Note 7 “Convertible Senior Notes”), repayment of the principal amounts will be bifurcated between (i) cash outflows for operating activities for the portion related to accreted interest attributable to debt discounts arising from the difference between the coupon interest rate and the effective interest rate, and (ii) financing activities for the remainder. See Note 7 “Convertible Senior Notes” regarding timing of settlement. The Company adopted ASU 2016-15 on January 1, 2018 with no impact on its consolidated financial statements.

Recent Accounting Pronouncements Not Yet Effective

In January 2017, FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment (“ASU 2017-04”). ASU 2017-04 removes the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment charge will be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The update to the standard is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted, and should be applied prospectively. The Company does not expect ASU 2017-04 to have a material impact on its consolidated financial statements.

In June 2016, FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). ASU 2016-13 changes the impairment model for most financial assets, and will require the use of an expected loss model in place of the currently used incurred loss method. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The update to the standard is effective for interim and annual periods beginning after December 15, 2019. The Company is currently evaluating the impact of the adoption of ASU 2016-13 on its consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”), which requires lessees to put most leases on their balance sheets but recognize the expenses on their statements of operations in a manner similar to current practice. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The new standard is effective for interim and annual periods beginning after December 15, 2018 and early adoption is permitted. While the Company is currently assessing the impact ASU 2016-02 will have on the Company’s consolidated financial statements, the Company expects the primary impact to its consolidated financial position upon adoption will be the recognition, on a discounted basis, of the Company’s minimum commitments under non-cancelable operating leases on its consolidated balance sheets resulting in the recording of right of use assets and lease obligations.

2. Revenue, Deferred Revenue and Deferred Contract Costs

Effective January 1, 2018, the Company adopted ASC 606 using the full retrospective method. Under this method, the Company is presenting the consolidated financial statements as of December 31, 2017, and for the three and six months ended June 30, 2017, as if ASC 606 had been effective for those periods. The most significant impact of the standard related to i) the timing of revenue recognition for contracts related to certain on-premise offerings, in which the Company granted customers the right to deploy its subscription software on the customers’ own servers. For these contracts, the Company is required to recognize as revenue a significant portion of the contract price upon delivery of the software compared to the previous practice of recognizing the entire contract price ratably over a subscription period; and ii) the timing of revenue recognition in instances when all revenue recognition criteria were not met until after the start date of the subscription. Previously these amounts were recognized prospectively over the remaining contract term, while under ASC 606, the Company is required to recognize revenue on a cumulative catch-up basis for amounts earned up to the time all revenue recognition criteria have been met. In addition, iii) certain contract acquisition costs such as sales commissions are being amortized over an expected benefit period that is longer than the Company’s previous policy of amortizing the deferred amounts over the specific revenue contract term for the associated contract.

The Company applied ASC 606 using two practical expedients: 1) for the reporting periods presented before January 1, 2018, the Company won’t disclose the amount of the transaction price allocated to the remaining performance obligations or an explanation of when the Company expects to recognize that amount as revenue; 2) the Company won’t disclose the amount of the transaction price allocated to the remaining performance obligations for contracts with an original expected length of one year or less.

Table of Contents

Select condensed consolidated balance sheet line items, which reflect the adoption of the new standard, are as follows:

	December 31, 2017		
	As Previously Reported	Adjustments	As Adjusted
Assets			
Accounts receivable, net	$109,325	$ (1,629)	$107,696
Deferred commissions, current	$27,144	$ (895)	$26,249
Long-term deferred commissions	$5,811	$ 46,143	$51,954
Liabilities			
Accrued liabilities	$63,926	$ 1,577	$65,503
Deferred revenue	$381,915	$ (17,394)	$364,521
Long-term deferred revenue	$69,873	$ (6,555)	$63,318
Stockholders' Equity			
Accumulated deficit	$(554,444)	$ 65,991	$(488,453)

Select unaudited condensed consolidated statements of operations line items, which reflect the adoption of the new standard, are as follows:

	Three Months Ended June 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Revenue:			
Subscription	$118,928	$ (225)	$118,703
Hardware and services	3,401	337	3,738
Total revenue	$122,329	$ 112	$122,441
Gross profit	$87,836	$ 112	$87,948
Operating expense:			
Sales and marketing	$62,454	$ (2,328)	$60,126
Operating loss	$(19,272)	$ 2,440	$(16,832)
Net loss	$(25,935)	$ 2,440	$(23,495)
Net loss per share, basic and diluted	$(0.59)	$ 0.05	$(0.54)

	Six Months Ended June 30, 2017		
	As Previously	Adjustments	As Adjusted

	Reported		
Revenue:			
Subscription	$229,853	$ 1,941	$231,794
Hardware and services	5,726	556	6,282
Total revenue	$235,579	$ 2,497	$238,076
Gross profit	$168,710	$ 2,497	$171,207
Operating expense:			
Sales and marketing	$121,186	$ (5,140)	$116,046
Operating loss	$(37,223)	$ 7,637	$(29,586)
Net loss	$(51,415)	$ 7,637	$(43,778)
Net loss per share, basic and diluted	$(1.18)	$ 0.18	$(1.00)

11

Table of Contents

Select unaudited condensed consolidated statement of cash flows line items, which reflect the adoption of the new standard are as follows:

	Six Months Ended June 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Cash flows from operating activities			
Net loss	$(51,415)	$ 7,637	$(43,778)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Amortization of deferred commissions	$—	$ 13,275	$13,275
Changes in assets and liabilities:			
Accounts receivable	$(2,725)	$ (21)	$(2,746)
Deferred commissions	$791	$ (18,414)	$(17,623)
Accrued liabilities	$		