

SALESFORCE COM INC

Form 10-Q

November 21, 2016

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 October 31, 2016

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 001-32224

salesforce.com, inc.

(Exact name of registrant as specified in its charter)

Delaware

94-3320693

(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

The Landmark @ One Market, Suite 300

San Francisco, California 94105

(Address of principal executive offices)

Telephone Number (415) 901-7000

(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 (the "Exchange Act") 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 October 31, 2016, there were approximately 696.7 million shares of the Registrant's Common Stock outstanding.



Table of Contents

## INDEX

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements:</u>	
Consolidated Balance Sheets as of October 31, 2016 and January 31, 2016	<u>3</u>
Consolidated Statements of Operations for the three and nine months ended October 31, 2016 and 2015	<u>4</u>
Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended October 31, 2016 and 2015	<u>5</u>
Consolidated Statements of Cash Flows for the three and nine months ended October 31, 2016 and 2015	<u>6</u>
Notes to Consolidated Financial Statements	<u>8</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>42</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>70</u>
Item 4. <u>Controls and Procedures</u>	<u>72</u>
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>73</u>
Item 1A. <u>Risk Factors</u>	<u>73</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>89</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>89</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>89</u>
Item 5. <u>Other Information</u>	<u>89</u>
Item 6. <u>Exhibits</u>	<u>89</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

salesforce.com, inc.

Consolidated Balance Sheets

(in thousands)

	October 31, 2016 (unaudited)	January 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$1,145,736	\$1,158,363
Short-term marketable securities	55,071	183,018
Accounts receivable, net	1,281,425	2,496,165
Deferred commissions	237,729	259,187
Prepaid expenses and other current assets	281,593	250,594
Total current assets	3,001,554	4,347,327
Marketable securities, noncurrent	550,323	1,383,996
Property and equipment, net	1,756,673	1,715,828
Deferred commissions, noncurrent	167,839	189,943
Capitalized software, net	637,877	384,258
Goodwill	6,616,999	3,849,937
Strategic investments	555,968	520,721
Other assets, net	1,100,436	370,910
Total assets	\$14,387,669	\$12,762,920
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable, accrued expenses and other liabilities	\$1,496,841	\$1,349,338
Deferred revenue	3,478,693	4,267,667
Total current liabilities	4,975,534	5,617,005
Convertible 0.25% senior notes, net	1,109,236	1,088,097
Term loan	496,934	0
Loan assumed on 50 Fremont	198,201	197,998
Deferred revenue, noncurrent	16,440	23,886
Other noncurrent liabilities	785,287	833,065
Total liabilities	7,581,632	7,760,051
Stockholders' equity:		
Common stock	697	671
Additional paid-in capital	7,281,753	5,705,386
Accumulated other comprehensive loss	(62,943 )	(49,917 )
Accumulated deficit (See Note 1)	(413,470 )	(653,271 )
Total stockholders' equity	6,806,037	5,002,869
Total liabilities and stockholders' equity	\$14,387,669	\$12,762,920

See accompanying Notes.

3

---

Table of Contents

salesforce.com, inc.

Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Revenues:				
Subscription and support	\$1,983,981	\$1,596,333	\$5,645,554	\$4,522,939
Professional services and other	160,794	115,634	452,442	334,879
Total revenues	2,144,775	1,711,967	6,097,996	4,857,818
Cost of revenues (1)(2):				
Subscription and support	411,363	303,045	1,108,134	870,023
Professional services and other	174,159	120,638	499,948	340,846
Total cost of revenues	585,522	423,683	1,608,082	1,210,869
Gross profit	1,559,253	1,288,284	4,489,914	3,646,949
Operating expenses (1)(2):				
Research and development	311,459	239,212	863,935	695,440
Marketing and sales	997,993	818,820	2,828,784	2,349,449
General and administrative	246,765	186,818	709,622	544,314
Operating lease termination resulting from purchase of 50 Fremont	0	0	0	(36,617 )
Total operating expenses	1,556,217	1,244,850	4,402,341	3,552,586
Income from operations	3,036	43,434	87,573	94,363
Investment income	3,709	3,507	23,747	11,351
Interest expense	(21,946 )	(18,249 )	(64,665 )	(53,020 )
Other income (expense) (1)	1,782	(7,093 )	(11,500 )	(6,064 )
Gain on sales of land and building improvements	0	21,792	0	21,792
Gains on sales of strategic investments	833	0	13,697	0
Income (loss) before benefit from (provision for) income taxes	(12,586 )	43,391	48,852	68,422
Benefit from (provision for) income taxes (3)	(24,723 )	(68,548 )	182,220	(90,339 )
Net income (loss)	\$(37,309 )	\$(25,157 )	\$231,072	\$(21,917 )
Basic net income (loss) per share	\$(0.05 )	(0.04 )	\$0.34	(0.03 )
Diluted net income (loss) per share	\$(0.05 )	(0.04 )	\$0.33	(0.03 )
Shares used in computing basic net income (loss) per share	690,468	664,131	683,075	659,160
Shares used in computing diluted net income (loss) per share	690,468	664,131	696,257	659,160

(1) Amounts include amortization of purchased intangibles from business combinations, as follows:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Cost of revenues	\$36,703	\$20,296	\$84,462	\$60,825
Marketing and sales	28,064	18,966	66,601	57,995
Other non-operating expense	579	761	1,927	2,877

(2) Amounts include stock-based expense, as follows

	Three Months Ended October 31,		Nine Months Ended October 31,	
--	--------------------------------------	--	----------------------------------	--

Edgar Filing: SALESFORCE COM INC - Form 10-Q

	2016	2015	2016	2015
Cost of revenues	\$26,783	\$17,516	\$76,912	\$49,237
Research and development	50,372	31,534	124,164	96,508
Marketing and sales	93,718	69,561	275,515	211,819
General and administrative	33,878	25,706	99,389	77,092

(3) Amounts include a \$205.6 million tax benefit recorded during the nine months ended October 31, 2016 as a result of the release of a portion of the valuation allowance related to the Demandware, Inc. acquisition. See Note 8 "Income Taxes."

See accompanying Notes.

Table of Contents

salesforce.com, inc.

Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2016	2015	2016	2015
Net income (loss)	\$(37,309)	\$(25,157)	\$231,072	\$(21,917)
Other comprehensive loss, before tax and net of reclassification adjustments:				
Foreign currency translation and other losses	(28,372 )	(1,173 )	(28,523 )	(8,419 )
Unrealized gains (losses) on investments	(16,019 )	(2,873 )	20,961	337
Other comprehensive loss, before tax	(44,391 )	(4,046 )	(7,562 )	(8,082 )
Tax effect	(7,337 )	(1,135 )	(5,464 )	(1,135 )
Other comprehensive loss, net of tax	(51,728 )	(5,181 )	(13,026 )	(9,217 )
Comprehensive income (loss)	\$(89,037)	\$(30,338)	\$218,046	\$(31,134)

See accompanying Notes.





Table of Contents

salesforce.com, inc.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2016	2015	2016	2015
Operating activities:				
Net income (loss)	\$(37,309	) \$(25,157	) \$231,072	\$(21,917
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	169,346	134,236	451,479	393,838
Amortization of debt discount and transaction costs	7,281	7,138	21,334	20,290
Gain on sales of land and building improvements	0	(21,792	) 0	(21,792
Gains on sales of strategic investments	(833	) 0	(13,697	) 0
50 Fremont lease termination	0	0	0	(36,617
Abandonment of leasehold improvement	0	7,086	0	7,086
Amortization of deferred commissions	93,230	78,934	270,527	232,768
Expenses related to employee stock plans	204,751	144,317	575,980	434,656
Changes in assets and liabilities, net of business combinations:				
Accounts receivable, net	42,653	15,262	1,276,798	853,014
Deferred commissions	(92,803	) (80,030	) (226,965	) (200,867
Prepaid expenses and other current assets and other assets	40,676	33,841	(25,723	) 4,495
Accounts payable, accrued expenses and other liabilities	57,836	57,577	(275,058	) 12,276
Deferred revenue	(330,516	) (188,898	) (829,695	) (475,357
Net cash provided by operating activities (1)	154,312	162,514	1,456,052	1,201,873
Investing activities:				
Business combinations, net of cash acquired	(32,117	) (27,759	) (2,832,110	) (58,680
Proceeds from land and building improvements held for sale	0	127,066	0	127,066
Purchase of 50 Fremont land and building	0	0	0	(425,376
Deposit for purchase of 50 Fremont land and building	0	0	0	115,015
Non-refundable amounts received for sale of land available for sale	0	0	0	6,284
Strategic investments, net	(16,877	) (30,330	) (39,328	) (325,226
Purchases of marketable securities	(111,731	) (200,001	) (986,862	) (543,422
Sales of marketable securities	93,391	91,153	1,927,049	414,259
Maturities of marketable securities	14,203	7,166	64,741	23,445
Capital expenditures	(140,653	) (80,041	) (319,984	) (216,011
Net cash used in investing activities	(193,784	) (112,746	) (2,186,494	) (882,646
Financing activities:				
Proceeds from term loan, net	0	0	495,550	0
Proceeds from employee stock plans	92,846	98,016	315,865	367,830
Principal payments on capital lease obligations	(10,997	) (10,945	) (73,760	) (68,844
Payments on revolving credit facility	0	0	0	(300,000
Net cash provided by (used in) financing activities (1)	81,849	87,071	737,655	(1,014
Effect of exchange rate changes	(11,867	) (2,872	) (19,840	) (3,012
Net increase (decrease) in cash and cash equivalents	30,510	133,967	(12,627	) 315,201
Cash and cash equivalents, beginning of period	1,115,226	1,089,351	1,158,363	908,117
Cash and cash equivalents, end of period	\$1,145,736	\$1,223,318	\$1,145,736	\$1,223,318

During the nine months ended October 31, 2016, the Company early adopted Accounting Standards Update No. 2016-09, "Improvements to Employee Share-Based Payment Accounting (Topic 718)" ("ASU 2016-09"), which addresses among other items, updates to the presentation and treatment of excess tax benefits related to stock based compensation. Excess tax benefits are no longer classified as a reduction of operating cash flows. The Company has adopted changes to the consolidated statements of cash flows on a retrospective basis. The impact for the three and nine months ended October 31, 2015 was an increase of \$44,607 and \$48,698 to net cash provided by operating activities with a correlating decrease of equal amounts to net cash provided by (used in) financing activities, respectively.

See accompanying Notes.

Table of Contents

salesforce.com, inc.

Consolidated Statements of Cash Flows

Supplemental Cash Flow Disclosure

(in thousands)

(unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Supplemental cash flow disclosure:				
Cash paid during the period for:				
Interest	\$11,365	\$4,085	\$41,400	\$32,756
Income taxes, net of tax refunds	\$11,220	\$8,248	\$25,451	\$24,450
Non-cash operating, financing and investing activities:				
Fixed assets acquired under capital leases	\$180	\$2,065	\$765	\$7,191
Building - leased facility acquired under financing obligation	\$0	\$38,477	\$0	\$75,336
Fair value of loan assumed on 50 Fremont	\$0	\$0	\$0	\$198,751
Fair value of equity awards assumed	\$26,406	\$0	\$47,199	\$0
Fair value of common stock issued as consideration for business combinations	\$492,842	\$0	\$771,214	\$0
Non-cash equity liability (See Note 6)	\$(1,473 )	\$0	\$74,570	\$0

See accompanying Notes.

Table of Contents

salesforce.com, inc.

Notes to Consolidated Financial Statements

1. Summary of Business and Significant Accounting Policies

Description of Business

Salesforce.com, inc. (the “Company”) is a leading provider of enterprise cloud computing solutions, with a focus on customer relationship management, or CRM. The Company introduced its first CRM solution in February 2000, and has since expanded its service offerings with new editions, solutions, features and platform capabilities.

The Company's mission is to help its customers transform themselves into customer-centric companies by empowering them to connect with their customers in entirely new ways. The Company's Customer Success Platform includes, among other things, sales force automation, customer service and support, marketing automation, commerce, community management, analytics, application development, Internet of Things integration and professional cloud services, which provide the next-generation platform of enterprise applications and services to enable customer success.

Fiscal Year

The Company's fiscal year ends on January 31. References to fiscal 2017, for example, refer to the fiscal year ending January 31, 2017.

Basis of Presentation

The accompanying consolidated balance sheet as of October 31, 2016 and the consolidated statements of operations, the consolidated statements of comprehensive income (loss) and the consolidated statements of cash flows for the three and nine months ended October 31, 2016 and 2015, respectively, are unaudited.

These financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information. Accordingly, they do not include all of the financial information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of the Company's management, the unaudited consolidated financial statements include all adjustments necessary for the fair presentation of the Company's balance sheet as of October 31, 2016, and its results of operations, including its comprehensive income (loss), and its cash flows for the three and nine months ended October 31, 2016 and 2015. All adjustments are of a normal recurring nature. The results for the three and nine months ended October 31, 2016 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2017.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2016, filed with the Securities and Exchange Commission (the “SEC”) on March 7, 2016 as updated by the Form 8-K filed with the SEC on September 1, 2016.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in the Company's consolidated financial statements and notes thereto.

Significant estimates and assumptions made by management include the determination of:

- the best estimate of selling price of the deliverables included in multiple deliverable revenue arrangements,
- the fair value of assets acquired and liabilities assumed for business combinations,
- the recognition, measurement and valuation of current and deferred income taxes,
- the fair value of stock awards issued and related forfeiture rates,
- the useful lives of intangible assets, property and equipment and building and structural components, and
- the valuation of strategic investments and the determination of other-than-temporary impairments.



Table of Contents

Actual results could differ materially from those estimates. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the result of which forms the basis for making judgments about the carrying values of assets and liabilities.

**Principles of Consolidation**

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

**Segments**

The Company operates as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, who is the chief executive officer, in deciding how to allocate resources and assessing performance. Over the past few years, including fiscal 2017, the Company has completed a number of acquisitions. These acquisitions have allowed the Company to expand its offerings, presence and reach in various market segments of the enterprise cloud computing market. While the Company has offerings in multiple enterprise cloud computing market segments, including as a result of the Company's acquisitions, the Company's business operates in one operating segment because the majority of the Company's offerings operate on a single platform and are deployed in an identical way, and the Company's chief operating decision maker evaluates the Company's financial information and resources and assesses the performance of these resources on a consolidated basis. Since the Company operates in one operating segment, all required financial segment information can be found in the consolidated financial statements.

**Concentrations of Credit Risk and Significant Customers**

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities and trade accounts receivable. Collateral is not required for accounts receivable. The Company maintains an allowance for doubtful accounts receivable balances. This allowance is based upon historical loss patterns, the number of days that billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts.

No single customer accounted for more than five percent of accounts receivable at October 31, 2016 and January 31, 2016. No single customer accounted for five percent or more of total revenue during the three and nine months ended October 31, 2016 and 2015.

**Geographic Locations**

As of October 31, 2016 and January 31, 2016, assets located outside the Americas were 9 percent and 11 percent of total assets, respectively.

Revenues by geographical region are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2016	2015	2016	2015
Americas	\$1,598,344	\$1,258,148	\$4,506,774	\$3,575,441
Europe	337,497	302,704	1,012,671	848,413
Asia Pacific	208,934	151,115	578,551	433,964
	\$2,144,775	\$1,711,967	\$6,097,996	\$4,857,818

Americas revenue attributed to the United States was approximately 96 percent and 95 percent during the three and nine months ended October 31, 2016 and 2015, respectively. No other country represented more than ten percent of total revenue during the three and nine months ended October 31, 2016 and 2015.

**Revenue Recognition**

The Company derives its revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing the Company's enterprise cloud computing services and from customers paying for additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue.

"Other revenue" consists primarily of training fees.





## Table of Contents

The Company commences revenue recognition when all of the following conditions are satisfied:

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

The Company's subscription service arrangements are non-cancelable and do not contain refund-type provisions.

### Subscription and Support Revenues

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement date of each contract, which is the date the Company's service is made available to customers.

Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

### Professional Services and Other Revenues

The Company's professional services contracts are either on a time and material or fixed fee basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized as the services are performed.

### Multiple Deliverable Arrangements

The Company enters into arrangements with multiple deliverables that generally include multiple subscriptions, premium support and professional services. If the deliverables have standalone value upon delivery, the Company accounts for each deliverable separately. Subscription services have standalone value as such services are often sold separately. In determining whether professional services have standalone value, the Company considers the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date and the contractual dependence of the subscription service on the customer's satisfaction with the professional services work. To date, the Company has concluded that all of the professional services included in multiple deliverable arrangements executed have standalone value.

Multiple deliverables included in an arrangement are separated into different units of accounting and the arrangement consideration is allocated to the identified separate units based on a relative selling price hierarchy. The Company determines the relative selling price for a deliverable based on its vendor-specific objective evidence of selling price ("VSOE"), if available, or its best estimate of selling price ("BESP"), if VSOE is not available. The Company has determined that third-party evidence of selling price ("TPE") is not a practical alternative due to differences in its service offerings compared to other parties and the availability of relevant third-party pricing information. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

For certain professional services, the Company has established VSOE as a consistent number of standalone sales of these deliverables have been priced within a reasonably narrow range. The Company has not established VSOE for its subscription services due to lack of pricing consistency, the introduction of new services and other factors.

Accordingly, the Company uses its BESP to determine the relative selling price for its subscription services.

The Company determines BESP by considering its overall pricing objectives and market conditions. Significant pricing practices taken into consideration include the Company's discounting practices, the size and volume of the Company's transactions, the customer demographic, the geographic area where services are sold, price lists, its go-to-market strategy, historical standalone sales and contract prices. The determination of BESP is made through consultation with and approval by the Company's management, taking into consideration the go-to-market strategy. As the Company's go-to-market strategies evolve, the Company may modify its pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BESP.

Table of Contents

Deferred Revenue

The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription services described above and is recognized as the revenue recognition criteria are met. The Company generally invoices customers in annual installments. The deferred revenue balance is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing, dollar size and new business linearity within the quarter.

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

Deferred Commissions

Deferred commissions are the incremental costs that are directly associated with non-cancelable subscription contracts with customers and consist of sales commissions paid to the Company's direct sales force.

The commissions are deferred and amortized over the non-cancelable terms of the related customer contracts, which are typically 12 to 36 months. The commission payments are paid in full the month after the customer's service commences and are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. The Company believes this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the same period that the subscription revenue is recognized. Amortization of deferred commissions is included in marketing and sales expense in the accompanying consolidated statements of operations.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents are stated at fair value.

Marketable Securities

Management determines the appropriate classification of marketable securities at the time of purchase and reevaluates such determination at each balance sheet date. Securities are classified as available for sale and are carried at fair value, with the change in unrealized gains and losses, net of tax, reported as a separate component on the consolidated statements of comprehensive income (loss). Fair value is determined based on quoted market rates when observable or utilizing data points that are observable, such as quoted prices, interest rates and yield curves. Declines in fair value judged to be other-than-temporary on securities available for sale are included as a component of investment income. In order to determine whether a decline in value is other-than-temporary, the Company evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value and its intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. The cost of securities sold is based on the specific-identification method. Interest on securities classified as available for sale is also included as a component of investment income.

Fair Value Measurement

The Company measures its cash equivalents, marketable securities and foreign currency derivative contracts at fair value. The additional disclosures regarding the Company's fair value measurements are included in Note 2 "Investments."

Table of Contents

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated useful lives of those assets as follows:

Computers, equipment and software	3 to 9 years
Furniture and fixtures	5 years
Leasehold improvements	Shorter of the estimated lease term or 10 years
Building and structural components	Average weighted useful life of 32 years
Building- leased facility	27 years
Building improvements	10 years

When assets are retired or otherwise disposed of, the cost and accumulated depreciation and amortization are removed from their respective accounts and any loss on such retirement is reflected in operating expenses.

Capitalized Internal-Use Software Costs

The Company capitalizes costs related to its enterprise cloud computing services and certain projects for internal use incurred during the application development stage. Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its estimated useful life, which is generally three to five years. Management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

Goodwill and Intangible Assets Impairment Assessments

The Company evaluates and tests the recoverability of its goodwill for impairment at least annually during the fourth quarter or more often if and when circumstances indicate that goodwill may not be recoverable.

Intangible assets are amortized over their useful lives. Each period the Company evaluates the estimated remaining useful life of its intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization. The carrying amounts of these assets are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable.

Recoverability of these assets is measured by comparison of the carrying amount of each asset to the future undiscounted cash flows the asset is expected to generate. If the undiscounted cash flows used in the test for recoverability are less than the carrying amount of these assets, then the carrying amount of such assets is reduced to fair value.

Long-Lived Assets and Impairment Assessment

The Company evaluates long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. This includes but is not limited to significant adverse changes in business climate, market conditions, or other events that indicate an asset's carrying amount may not be recoverable. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value. There was no impairment of long-lived assets during the three and nine months ended October 31, 2016 and 2015, respectively.

Business Combinations

The Company uses its best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date. The Company's estimates are inherently uncertain and subject to refinement. During the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the fair value of these tangible and intangible assets acquired and liabilities assumed, with the corresponding offset to goodwill. In addition, uncertain tax positions and tax-related valuation allowances are initially established in connection with a business combination as of the acquisition date. The Company continues to collect information and reevaluates these estimates and assumptions quarterly and records any adjustments to the Company's preliminary estimates to goodwill provided that the Company is within the measurement period. Upon the conclusion of the measurement period or final determination of the fair value of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to the Company's consolidated statements of operations.

In the event that the Company enters into a business combination with an entity in which the Company previously held a strategic investment, significant gains or losses will be disclosed separately within the statements of operations.

Table of Contents

## Leases and Asset Retirement Obligations

The Company categorizes leases at their inception as either operating or capital leases. In certain lease agreements, the Company may receive rent holidays and other incentives. The Company recognizes lease costs on a straight-line basis once control of the space is achieved, without regard to deferred payment terms such as rent holidays that defer the commencement date of required payments. Additionally, incentives received are treated as a reduction of costs over the term of the agreement.

The Company establishes assets and liabilities for the present value of estimated future costs to retire long-lived assets at the termination or expiration of a lease. Such assets are depreciated over the lease period to operating expense.

In the event the Company is the deemed owner for accounting purposes during construction, the Company records assets and liabilities for the estimated construction costs incurred under build-to-suit lease arrangements to the extent it is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease.

The Company additionally has entered into subleases for unoccupied leased office space. To the extent there are losses associated with the sublease, they are recognized in the period the sublease is executed. Gains are recognized over the sublease life. Any sublease payments received in excess of the straight-line rent payments for the sublease are recorded in other income (expense).

## Accounting for Stock-Based Expense

The Company recognizes stock-based expenses related to stock options and restricted stock awards on a straight-line basis over the requisite service period of the awards, which is generally the vesting term of four years. The aggregate stock compensation remaining to be amortized to costs and expenses will be recognized over a weighted average period of 2.7 years. The Company recognizes stock-based expenses related to shares issued pursuant to its Amended and Restated 2004 Employee Stock Purchase Plan (“ESPP” or “2004 Employee Stock Purchase Plan”) on a straight-line basis over the offering period, which is 12 months. Stock-based expenses are recognized net of estimated forfeiture activity. The estimated forfeiture rate applied is based on historical forfeiture rates. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option pricing model.

The fair value of each stock option grant and ESPP share was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions and fair value per share:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Stock Options				
Volatility	32.3 %	35 %	32.1-32% <del>32.1-32%</del>	35-37 %
Estimated life	3.5 years	3.6 years	3.5 years	3.6 years
Risk-free interest rate	0.91-1.07 <del>0.91-1.07</del>	1.21-1.27 %	0.89-1.07 <del>0.89-1.07</del>	1.13-1.42 <del>1.13-1.42</del>
Weighted-average fair value per share of grants	\$18.75	\$19.72	\$18.75	\$19.79

The Company estimated its future stock price volatility considering both its observed option-implied volatilities and its historical volatility calculations. Management believes this is the best estimate of the expected volatility over the expected life of its stock options and stock purchase rights. The estimated life for the stock options was based on an analysis of historical exercise activity.

ESPP assumptions and the related fair value per share table will only be disclosed in the three month period in which there is ESPP activity, such as an ESPP purchase. The Company's ESPP Plan allows for two purchases during the year, one during the second quarter and one during the fourth quarter. The estimated life of the ESPP will be based on the two purchase periods within each offering period.

The risk-free interest rate is based on the rate for a U.S. government security with the same estimated life at the time of the option grant and the stock purchase rights.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and

Table of Contents

liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax laws is recognized in the consolidated statement of operations in the period that includes the enactment date.

Valuation allowances are established when necessary to reduce deferred tax assets to the amounts that are more likely than not expected to be realized based on the weighting of positive and negative evidence. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback or carryforward periods available under the applicable tax law. The Company regularly reviews the deferred tax assets for recoverability based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. The Company's judgments regarding future profitability may change due to many factors, including future market conditions and the ability to successfully execute its business plans and/or tax planning strategies. Should there be a change in the ability to recover deferred tax assets, the tax provision would increase or decrease in the period in which the assessment is changed.

The Company's tax positions are subject to income tax audits by multiple tax jurisdictions throughout the world. The Company recognizes the tax benefit of an uncertain tax position only if it is more likely than not that the position is sustainable upon examination by the taxing authority, solely based on its technical merits. The tax benefit recognized is measured as the largest amount of benefit which is greater than 50 percent likely to be realized upon settlement with the taxing authority. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in the income tax provision.

**Foreign Currency Translation**

The functional currency of the Company's major foreign subsidiaries is generally the local currency. Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are recorded as a separate component on the consolidated statements of comprehensive income (loss). Foreign currency transaction gains and losses are included in net income (loss) for the period. All assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the exchange rate on the balance sheet date. Revenues and expenses are translated at the average exchange rate during the period. Equity transactions are translated using historical exchange rates.

**Warranties and Indemnification**

The Company's enterprise cloud computing services are typically warranted to perform in a manner consistent with general industry standards that are reasonably applicable and materially in accordance with the Company's online help documentation under normal use and circumstances.

The Company's arrangements generally include certain provisions for indemnifying customers against liabilities if its products or services infringe a third party's intellectual property rights. To date, the Company has not incurred any material costs as a result of such obligations and has not accrued any material liabilities related to such obligations in the accompanying consolidated financial statements.

The Company has also agreed to indemnify its directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person's service as a director or officer, including any action by the Company, arising out of that person's services as the Company's director or officer or that person's services provided to any other company or enterprise at the Company's request. The Company maintains director and officer insurance coverage that would generally enable the Company to recover a portion of any future amounts paid. The Company may also be subject to indemnification obligations by law with respect to the actions of its employees under certain circumstances and in certain jurisdictions.

Table of Contents

New Accounting Pronouncements Adopted in Fiscal 2017

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2015-03, “Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs” (“ASU 2015-03”), which simplifies the presentation of debt issuance costs by requiring debt issuance costs to be presented as a deduction from the corresponding debt liability rather than an asset that is amortized. However, ASU 2015-03 does not address deferred issuance costs for line-of-credit arrangements; therefore, in August 2015, the FASB issued Accounting Standards Update No. 2015-15, “Interest-Imputation of Interest: Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements” (“ASU 2015-15”). ASU 2015-15 allows an entity to defer debt issuance costs associated with line-of-credit arrangements, including arrangements with no outstanding borrowings, and classify them as an asset, and amortize them over the term of the arrangements. The recognition and measurement guidance for debt issuance costs is not affected by the standards. The Company adopted the standards in the three months ended April 30, 2016. Upon adoption, the unamortized debt issuance costs previously reported in Other assets, net, with a carrying amount of approximately \$7.9 million at January 31, 2016, were reclassified and presented as a deduction of the corresponding liabilities, Convertible 0.25% senior notes, net, Term Loan, and Loan assumed on 50 Fremont.

In September 2015, the FASB issued Accounting Standards Update No. 2015-16, “Simplifying the Accounting for Measurement-Period Adjustments (Topic 805)” (“ASU 2015-16”), which eliminates the requirement to restate prior period financial statements for measurement period adjustments in business combinations. ASU 2015-16 requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. The Company adopted this standard during the three months ended April 30, 2016 and there was no material impact of this on the Company's financial statements.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, “Stock Compensation (Topic 718): Improvements to Employee Shared-Based Payment Accounting” (“ASU 2016-09”), which simplifies and improves several aspects of the accounting for employee share-based payment transactions for public entities. The new guidance requires companies to record excess tax benefits and tax deficiencies as income tax benefit or expense in the statement of operations when the awards vest or are settled, and eliminates the requirement to reclassify cash flows related to excess tax benefits from operating activities to financing activities on the statement of cash flows. The Company adopted the standard in the three months ended April 30, 2016. Upon adoption, the Company recognized the previously unrecognized excess tax benefits using the modified retrospective transition method, which resulted in a cumulative-effect adjustment of \$8.7 million to accumulated deficit. This adjustment reduced the April 30, 2016 accumulated deficit balance. The previously unrecognized excess tax effects were recorded as a deferred tax asset, which was fully offset by a valuation allowance. Without the valuation allowance, the Company’s deferred tax asset would have increased by \$614.5 million. The Company also elected to apply the change in presentation to the statements of cash flows retrospectively and no longer classified the excess tax benefits from employee stock plans as a reduction from operating cash flows for all periods presented.

Pending Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”) which amended the existing FASB Accounting Standards Codification. This standard establishes a principle for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. The standard also provides guidance on the recognition of costs related to obtaining customer contracts. The FASB deferred the effective date for the new revenue reporting standard for entities reporting under U.S. GAAP for one year. In accordance with the deferral, ASU 2014-09 will be effective for fiscal 2019, including interim periods within that reporting period. The Company is currently in the process of assessing the adoption methodology, which allows the amendment to be applied retrospectively to each prior period presented, or with the cumulative effect recognized as of the date of initial application. The Company is also evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements and has not determined whether the effect will be material to either its revenue



results or its accounting for deferred commissions balances.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, “Financial Instrument-Overall (Subtopic 825-10)” (“ASU 2016-01”), which requires entities to measure equity investments at fair value and recognize any changes in fair value in net income. However, for equity investments that do not have readily determinable fair values and do not qualify for the existing practical expedient, the investments will be measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The new standard is effective for interim and annual periods beginning after December 15, 2017 and early adoption is permitted. The Company is currently evaluating the impact of the adoption of ASU 2016-01 on its consolidated financial statements.

Table of Contents

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which requires lessees to record most leases on their balance sheets but recognize the expenses on their income statements 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. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

In October 2016, the FASB issued Accounting Standards Update No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”)”, which requires entities to recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The new standard is effective for annual periods beginning after December 15, 2017, with early adoption permitted as of the beginning of a fiscal year. The Company is currently evaluating the impact of the adoption of ASU 2016-16 on its consolidated financial statements.

## 2. Investments

## Marketable Securities

At October 31, 2016, marketable securities consisted of the following (in thousands):

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	\$ 308,381	\$ 2,262	\$ (482 )	\$ 310,161
U.S. treasury securities	52,692	132	(43 )	52,781
Mortgage backed obligations	77,723	138	(198 )	77,663
Asset backed securities	111,806	310	(23 )	112,093
Municipal securities	45,388	235	(33 )	45,590
Foreign government obligations	7,090	19	(3 )	7,106
Total marketable securities	\$ 603,080	\$ 3,096	\$ (782 )	\$ 605,394

At January 31, 2016, marketable securities consisted of the following (in thousands):

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	\$ 949,266	\$ 1,398	\$ (2,983 )	\$ 947,681
U.S. treasury securities	157,625	375	(56 )	157,944
Mortgage backed obligations	104,242	106	(323 )	104,025
Asset backed securities	271,292	186	(226 )	271,252
Municipal securities	44,934	209	(6 )	45,137
Foreign government obligations	18,014	42	(5 )	18,051
U.S. agency obligations	16,076	16	(6 )	16,086
Covered bonds	6,690	148	0	6,838
Total marketable securities	\$ 1,568,139	\$ 2,480	\$ (3,605 )	\$ 1,567,014

The duration of the investments classified as marketable securities is as follows (in thousands):

	As of October 31, 2016	As of January 31, 2016
Recorded as follows:		
Short-term (due in one year or less)	\$ 55,071	\$ 183,018
Long-term (due after one year)	550,323	1,383,996
	\$ 605,394	\$ 1,567,014



Table of Contents

As of October 31, 2016, the following marketable securities were in an unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate notes and obligations	\$59,612	\$ (473 )	\$4,594	\$ (9 )	\$64,206	\$ (482 )
U.S. treasury securities	20,294	(43 )	0	0	20,294	(43 )
Mortgage backed obligations	40,964	(195 )	224	(3 )	41,188	(198 )
Asset backed securities	24,713	(17 )	1,862	(6 )	26,575	(23 )
Municipal securities	6,689	(33 )	0	0	6,689	(33 )
Foreign government obligations	4,092	(3 )	0	0	4,092	(3 )
	\$156,364	\$ (764 )	\$6,680	\$ (18 )	\$163,044	\$ (782 )

The unrealized losses for each of the fixed rate marketable securities were less than \$143,000. The Company does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of October 31, 2016. The Company expects to receive the full principal and interest on all of these marketable securities.

#### Fair Value Measurement

All of the Company's cash equivalents, marketable securities and foreign currency derivative contracts are classified within Level 1 or Level 2 because the Company's cash equivalents, marketable securities and foreign currency derivative contracts are valued using quoted market prices or alternative pricing sources and models utilizing observable market inputs.

The Company uses a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

Level 2. Other inputs that are directly or indirectly observable in the marketplace.

Level 3. Unobservable inputs which are supported by little or no market activity.

Table of Contents

The following table presents information about the Company's assets and liabilities that are measured at fair value as of October 31, 2016 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of October 31, 2016
Cash equivalents (1):				
Time deposits	\$ 0	\$ 110,796	\$ 0	\$ 110,796
Money market mutual funds	206,156	0	0	206,156
Marketable securities:				
Corporate notes and obligations	0	310,161	0	310,161
U.S. treasury securities	0	52,781	0	52,781
Mortgage backed obligations	0	77,663	0	77,663
Asset backed securities	0	112,093	0	112,093
Municipal securities	0	45,590	0	45,590
Foreign government obligations	0	7,106	0	7,106
Foreign currency derivative contracts (2)	0	1,372	0	1,372
Total assets	\$ 206,156	\$ 717,562	\$ 0	\$ 923,718
Liabilities				
Foreign currency derivative contracts (3)	\$ 0	\$ 4,838	\$ 0	\$ 4,838
Total liabilities	\$ 0	\$ 4,838	\$ 0	\$ 4,838

(1)Included in "cash and cash equivalents" in the accompanying consolidated balance sheet as of October 31, 2016, in addition to \$828.8 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying consolidated balance sheet as of October 31, 2016.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the consolidated balance sheet as of October 31, 2016.

Table of Contents

The following table presents information about the Company's assets and liabilities that are measured at fair value as of January 31, 2016 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of January 31, 2016
Cash equivalents (1):				
Time deposits	\$ 0	\$ 236,798	\$ 0	\$ 236,798
Money market mutual funds	216,107	0	0	216,107
Commercial paper	0	159,230	0	159,230
Agency and sovereign paper	0	13,599	0	13,599
Marketable securities:				
Corporate notes and obligations	0	947,681	0	947,681
U.S. treasury securities	0	157,944	0	157,944
Mortgage backed obligations	0	104,025	0	104,025
Asset backed securities	0	271,252	0	271,252
Municipal securities	0	45,137	0	45,137
Foreign government obligations	0	18,051	0	18,051
U.S. agency obligations	0	16,086	0	16,086
Covered bonds	0	6,838	0	6,838
Foreign currency derivative contracts (2)	0	4,731	0	4,731
Total Assets	\$ 216,107	\$ 1,981,372	\$ 0	\$ 2,197,479
Liabilities				
Foreign currency derivative contracts (3)	\$ 0	\$ 14,025	\$ 0	\$ 14,025
Total Liabilities	\$ 0	\$ 14,025	\$ 0	\$ 14,025

(1)Included in "cash and cash equivalents" in the accompanying consolidated balance sheet as of January 31, 2016, in addition to \$532.6 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying consolidated balance sheet as of January 31, 2016.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the accompanying consolidated balance sheet as of January 31, 2016.

#### Derivative Financial Instruments

The Company enters into foreign currency derivative contracts with financial institutions to reduce foreign exchange risk. The Company uses forward currency derivative contracts to minimize the Company's exposure to balances primarily denominated in British Pound Sterling, the Euro and Japanese Yen. The Company's foreign currency derivative contracts, which are not designated as hedging instruments, are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. The Company's derivative financial instruments program is not designated for trading or speculative purposes. As of October 31, 2016 and January 31, 2016, the foreign currency derivative contracts that were not settled were recorded at fair value on the consolidated balance sheets.

Foreign currency derivative contracts are marked-to-market at the end of each reporting period with gains and losses recognized as other expense to offset the gains or losses resulting from the settlement or remeasurement of the underlying foreign currency denominated receivables and payables. While the contract or notional amount is often used to express the volume of foreign currency derivative contracts, the amounts potentially subject to credit risk are generally limited to the amounts, if any, by which the counterparties' obligations under the agreements exceed the obligations of the Company to the counterparties.



Table of Contents

Details on outstanding foreign currency derivative contracts related primarily to intercompany receivables and payables are presented below (in thousands):

	As of	
	October 31, 2016	January 31, 2016
Notional amount of foreign currency derivative contracts	\$1,217,458	\$1,274,515
Fair value of foreign currency derivative contracts	\$(3,466 )	\$(9,294 )

The fair value of the Company's outstanding derivative instruments are summarized below (in thousands):

		Fair Value of Derivative Instruments	
		As of	
Balance Sheet Location		October 31, 2016	January 31, 2016
Derivative Assets			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Prepaid expenses and other current assets	\$ 1,372	\$ 4,731
Derivative Liabilities			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Accounts payable, accrued expenses and other liabilities	\$ 4,838	\$ 14,025

The effect of the derivative instruments not designated as hedging instruments on the consolidated statements of operations during the three and nine months ended October 31, 2016 and 2015, respectively, are summarized below (in thousands):

Derivatives Not Designated as Hedging Instruments		Losses on Derivative Instruments	
		Recognized in Other income (expense)	
		Three Months Ended	
Location		October 31, 2016	2015
Foreign currency derivative contracts	Other income (expense)	\$(39,624)	\$(2,888)
Derivatives Not Designated as Hedging Instruments		Income (loss) on Derivative Instruments	
		Recognized in Other income (expense)	
		Nine Months Ended	
Location		October 31, 2016	2015
Foreign currency derivative contracts	Other income (expense)	\$(86,528)	\$9,773



Table of Contents

## Investment Income

Investment income consists of interest income, realized gains and realized losses on the Company's cash, cash equivalents and marketable securities. The components of investment income are presented below (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Interest income	\$3,642	\$3,700	\$17,961	\$9,919
Realized gains	210	257	7,771	3,197
Realized losses	(143 )	(450 )	(1,985 )	(1,765 )
Total investment income	\$3,709	\$3,507	\$23,747	\$11,351

Reclassification adjustments out of accumulated other comprehensive income (loss) into net income were immaterial for the three and nine months ended October 31, 2016 and 2015, respectively.

## Strategic Investments

The Company's strategic investments are comprised of marketable equity securities and non-marketable debt and equity securities. Marketable equity securities are measured using quoted prices in their respective active markets and the non-marketable equity and debt securities are recorded at cost. These investments are presented on the consolidated balance sheets within strategic investments.

As of October 31, 2016, the Company had five investments in marketable equity securities with a fair value of \$42.4 million, which includes an unrealized gain of \$26.5 million. As of January 31, 2016, the Company had six investments in marketable equity securities with a fair value of \$16.2 million, which included an unrealized gain of \$8.5 million. The change in the fair value of the investments in publicly held companies is recorded in the consolidated balance sheets within strategic investments and accumulated other comprehensive loss.

The Company's interest in non-marketable debt and equity securities consists of noncontrolling debt and equity investments in privately held companies. The Company's investments in these privately held companies are reported at cost or marked down to fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. These investments are valued using significant unobservable inputs or data in an inactive market and the valuation requires the Company's judgment due to the absence of market prices and inherent lack of liquidity.

As of October 31, 2016 and January 31, 2016, the carrying value of the Company's non-marketable debt and equity securities was \$513.5 million and \$504.5 million, respectively. The estimated fair value of the non-marketable debt and equity securities was approximately \$752.1 million and \$714.1 million as of October 31, 2016 and January 31, 2016, respectively. These investments are measured using the cost method of accounting; therefore, the unrealized gains of \$238.6 million and \$209.6 million as of October 31, 2016 and January 31, 2016, respectively, are not recorded in the consolidated financial statements.

The carrying value of the Company's strategic investments is impacted by various events such as entering into new investments, disposition-related reductions of a cost-basis investment if a privately-held company within the portfolio is acquired by another company, fair market value adjustments or initial public offerings. The cash inflows from exits and cash outflows from new investments are disclosed as Strategic investments, net, within the investing activities section of the Statement of Cash Flows and any gains or losses or fair market value adjustments are recorded within the operating activities of the Statement of Cash Flows for each of the respective fiscal quarter periods.

Table of Contents

## 3. Property and Equipment

## Property and Equipment

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

	As of	
	October 31, 2016	January 31, 2016
Land	\$183,888	\$183,888
Buildings and building improvements	619,419	614,081
Computers, equipment and software	1,390,751	1,281,766
Furniture and fixtures	101,558	82,242
Leasehold improvements	586,040	473,688
	2,881,656	2,635,665
Less accumulated depreciation and amortization	(1,124,983 )	(919,837 )
	\$1,756,673	\$1,715,828

Depreciation and amortization expense totaled \$83.5 million and \$77.4 million during the three months ended October 31, 2016 and 2015, respectively, and totaled \$239.2 million and \$226.6 million during the nine months ended October 31, 2016 and 2015, respectively.

Computers, equipment and software at October 31, 2016 and January 31, 2016 included a total of \$729.3 million and \$747.1 million acquired under capital lease agreements, respectively. Accumulated amortization relating to computers, equipment and software under capital leases totaled \$364.8 million and \$310.3 million, respectively, at October 31, 2016 and January 31, 2016. Amortization of assets under capital leases is included in depreciation and amortization expense.

## Building - 350 Mission

In December 2013, the Company entered into a lease agreement for approximately 445,000 rentable square feet of office space at 350 Mission Street (“350 Mission”) in San Francisco, California, which is the total office space available in the building. As a result of the Company’s involvement during the construction period, the Company is considered for accounting purposes to be the owner of the construction project. As a result, the Company has capitalized the construction costs as Building with a corresponding current and noncurrent financing obligation liability and has accounted for the underlying land implicitly as an operating lease. As of October 31, 2016, the Company had capitalized \$178.8 million of construction costs, based on the construction costs incurred to date by the landlord, and recorded a corresponding current and noncurrent financing obligation liability of \$19.5 million and \$201.3 million, respectively. As of January 31, 2016, the Company had capitalized \$174.6 million of construction costs, based on the construction costs incurred to date by the landlord, and recorded a corresponding current and noncurrent financing obligation liability of \$15.4 million and \$196.7 million, respectively. The total expected financing obligation in the form of minimum lease payments inclusive of the amounts currently recorded, is \$327.7 million, including interest (see Note 10 “Commitments” for future commitment details). The obligation will be settled through monthly lease payments to the landlord, which commenced on October 2015. To the extent that operating expenses for 350 Mission are material, the Company, as the deemed accounting owner, will record the operating expenses.

## 4. Business Combinations

## BeyondCore

In September 2016, the Company acquired the outstanding stock of BeyondCore, Inc. (“BeyondCore”), for consideration consisting of cash, common stock, and equity awards assumed. BeyondCore is a smart data discovery technology company that automatically explores millions of variable combinations from structured data sources. The Company has included the financial results of BeyondCore in the consolidated financial statements from the date of acquisition, which have not been material to date. The transaction costs associated with the acquisition were not material.

The preliminary acquisition date fair value consideration transferred for BeyondCore was approximately \$106.6 million, which consisted of the following (in thousands, except for share data):



Table of Contents

	Fair Value
Cash	\$21,053
Common stock (1,073,432 shares)	81,484
Fair value of stock options and restricted stock awards assumed	4,061
Total	\$106,598

The fair value of stock options assumed by the Company was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.0464 was applied to convert BeyondCore's outstanding equity awards for BeyondCore's common stock into equity awards for shares of the Company's common stock.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition (in thousands):

	Fair Value
Cash and cash equivalents	\$2,046
Other current and noncurrent tangible assets	462
Intangible assets	15,600
Goodwill	90,794
Deferred revenue, current and noncurrent	(818 )
Other liabilities, current and noncurrent	(923 )
Deferred tax liability	(563 )
Net assets acquired	\$106,598

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible assets acquired, liabilities assumed and identifiable intangible assets are based on management's estimates and assumptions. The deferred tax liability established was primarily a result of the difference in the book basis and tax basis related to the identifiable intangible assets. The preliminary estimated fair values of assets acquired and liabilities assumed, including current and noncurrent income taxes payable and deferred taxes and identifiable intangible assets, may be subject to change as additional information is received and certain tax returns are finalized. Thus the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The following table sets forth the components of identifiable intangible assets acquired (in thousands) and their estimated useful lives as of the date of acquisition.

	Fair Value	Useful Life
Developed technology	\$14,900	6 years
Customer relationships	700	2 years
Total intangible assets subject to amortization	\$15,600	

The amount recorded for developed technology represents the estimated fair value of BeyondCore's smart data analytics technology. The amount recorded for customer relationships represents the fair values of the underlying relationship with BeyondCore customers. The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating BeyondCore's technology with the Company's other offerings. The goodwill balance is not deductible for U.S. income tax purposes.

The Company assumed equity awards for shares of BeyondCore's common stock with a fair value of \$8.6 million, of which \$4.1 million was allocated to the consideration transferred.

**Quip**

In August 2016, the Company acquired the outstanding stock of Quip, Inc. ("Quip") for consideration consisting of cash, common stock, fair value of equity awards assumed, as well as fair value of the Company's pre-existing relationship. Quip combines content and communication to create living documents to allow work-teams to write, edit and discuss documents,



Table of Contents

spreadsheets and checklists in a single experience. The Company acquired Quip for its product offerings and employees. The Company has included the financial results of Quip in the consolidated financial statements from the date of acquisition, which have not been material to date. The transaction costs associated with the acquisition were not material.

The preliminary acquisition date fair value consideration transferred for Quip was approximately \$412.0 million, which consisted of the following (in thousands, except for share data):

	Fair Value
Cash	\$2,711
Common stock (4,796,152 shares)	385,131
Fair value of stock options and restricted stock awards assumed	22,345
Fair value of pre-existing relationship	1,833
Total	\$412,020

The fair value of stock options assumed by the Company was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.5514 was applied to convert Quip's outstanding equity awards for Quip's common stock into equity awards for shares of the Company's common stock.

The Company had a \$1.0 million, or approximately 0.3 percent, noncontrolling equity investment in Quip prior to the acquisition. The acquisition date fair value of the Company's previously held equity interest was approximately \$1.8 million and is included in the measurement of the consideration transferred. The Company recognized a gain of approximately \$0.8 million as a result of remeasuring its prior equity interest in Quip held before the business combination. The gain is included in gains on sales of strategic investments in the consolidated statement of operations.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition (in thousands):

	Fair Value
Cash and cash equivalents	\$27,985
Other current and noncurrent tangible assets	556
Intangible assets	31,200
Goodwill	357,610
Other liabilities, current and noncurrent	(2,491 )
Deferred tax liability	(2,840 )
Net assets acquired	\$412,020

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible assets acquired, liabilities assumed and identifiable intangible assets are based on management's estimates and assumptions. The deferred tax liability established was primarily a result of the difference in the book basis and tax basis related to the identifiable intangible assets. The preliminary estimated fair values of assets acquired and liabilities assumed, including current and noncurrent income taxes payable and deferred taxes and identifiable intangible assets, may be subject to change as additional information is received and certain tax returns are finalized. Thus the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The following table sets forth the components of identifiable intangible assets acquired (in thousands) and their estimated useful lives as of the date of acquisition.

	Fair Value	Useful Life
Developed technology	\$18,590	5 years
Customer relationships	12,460	10 years
Other purchased intangible assets	150	3 years
Total intangible assets subject to amortization	\$31,200	



Table of Contents

The amount recorded for developed technology represents the estimated fair value of Quip's productivity technology. The amount recorded for customer relationships represents the fair values of the underlying relationship with Quip customers. The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating Quip's technology with the Company's other offerings. The goodwill balance is not deductible for U.S. income tax purposes.

The Company assumed equity awards for shares of Quip's common stock with a fair value of \$68.0 million, of which \$22.3 million was allocated to the consideration transferred.

**Demandware**

In July 2016, the Company acquired for cash the outstanding stock of Demandware, Inc. ("Demandware"), an industry-leading provider of enterprise cloud commerce solutions in the digital commerce market. The Company acquired Demandware to, among other things, expand the Company's position in customer relationship management and to pursue the digital commerce market with the new Salesforce Commerce Cloud. The Company has included the financial results of Demandware in the consolidated financial statements from the date of acquisition. The transaction costs associated with the acquisition were \$15.5 million and are recorded in general and administrative expense. The acquisition date fair value of the consideration transferred for Demandware was approximately \$2.9 billion, including the proceeds from the term loan of \$500.0 million (see Note 5), which consisted of the following (in thousands):

	Fair Value
Cash	\$2,920,336
Fair value of stock options and restricted stock awards assumed	9,344
Total	\$2,929,680

The estimated fair value of the stock options assumed by the Company was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.9545 was applied to convert Demandware's outstanding equity awards for Demandware's common stock into equity awards for shares of the Company's common stock.

The following table summarizes the preliminary estimated fair values of assets acquired and liabilities assumed as of the date of acquisition (in thousands):

	Fair Value
Cash and cash equivalents	\$139,259
Marketable securities	37,230
Accounts receivable	56,982
Other current assets	13,545
Customer contract asset, noncurrent	327,830
Intangible assets	633,277
Property and equipment	29,463
Other noncurrent assets	4,579
Goodwill	1,985,269
Accounts payable, accrued expenses and other liabilities	(51,870 )
Deferred revenue, current and noncurrent	(22,647 )
Other liabilities, noncurrent	(12,935 )
Deferred tax liability	(210,302 )
Net assets acquired	\$2,929,680

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions. The deferred tax liability established was primarily a result of the difference in the book basis and tax basis related to the identifiable intangible assets. The preliminary estimated fair values of assets acquired and liabilities assumed, specifically, the current and noncurrent income taxes payable and deferred taxes, may be subject to change as additional information is received and certain tax returns are finalized. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.





Table of Contents

In the second quarter of fiscal 2017, the Company accounted for acquired subscription contracts as two units of account, a customer contract asset and a customer contract liability. In the current quarter, the Company concluded that the acquired contracts should more appropriately be accounted for as a single unit of account and as such, the fair value of the contractual relationship with customers has been presented as a single, noncurrent intangible asset, customer contract asset. As a result of this change, the customer contract asset and the customer contract liability both decreased by \$393.9 million.

During the third quarter of fiscal 2017, the Company obtained additional information as it relates to the valuation of the customer relationship assets and therefore adjusted the measurement of the fair value of these assets. As a result of the updated valuation, the Company recorded measurement period adjustments, which included a decrease the fair value of the customer relationship asset by \$168.8 million. Additionally, these measurement period adjustments resulted in a corresponding decrease to the deferred tax liability recognized of \$61.2 million. The net effect of these changes resulted in a corresponding increase to goodwill of \$100.4 million.

The following table sets forth the components of identifiable intangible assets acquired and their preliminary estimated useful lives as of the date of acquisition (in thousands):

	Fair Value	Useful Life
Developed technology	\$242,550	to 5 years
Customer relationships	384,590	3 to 10 years
Other purchased intangible assets	6,137	3 to 10 years
Total intangible assets subject to amortization	\$633,277	

Developed technology represents the preliminary estimated fair value of Demandware's e-commerce technology. Customer relationships represent the preliminary estimated fair values of the underlying relationships with Demandware customers. Other purchased intangible assets also includes intangibles such as trademarks and favorable leases, which span over lease terms varying from 1 to 10 years. The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating Demandware's e-commerce technology with the Company's other offerings. The majority of the goodwill balance is not deductible for U.S. income tax purposes.

The Company assumed equity awards with an estimated fair value of \$135.2 million, of which \$9.3 million was allocated to the purchase consideration.

The amounts of revenue and earnings of Demandware included in the Company's consolidated statement of operations from the acquisition date of July 11, 2016 through October 31, 2016 are as follows (in thousands):

Total revenues	\$57,878
Pretax loss	(81,763 )
Net loss	(82,061 )

Table of Contents

The following pro forma financial information summarizes the combined results of operations for the Company and Demandware, as though the companies were combined as of the beginning of the Company's fiscal 2016.

The unaudited pro forma financial information was as follows (in thousands):

	Nine Months Ended	
	October 31,	
	2016	2015
Total revenues	\$6,176,166	\$4,958,491
Pretax loss	(100,817 )	(200,844 )
Net loss	(138,714 )	(37,097 )

The pro forma financial information for all periods presented has been calculated after adjusting the results of Demandware to reflect the business combination accounting effects resulting from this acquisition including the amortization expense from acquired intangible assets and the stock-based compensation expense for unvested stock options and restricted stock awards assumed as though the acquisition occurred as of the beginning of the Company's fiscal year 2016. The historical financial information has been adjusted to give effect to pro forma events that are directly attributable to the business combination and factually supportable. The pro forma financial information is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of the Company's fiscal 2016.

The pro forma financial information for the nine months ended October 31, 2016 and 2015 combines the historical results of the Company for the nine months ended October 31, 2016 and 2015, the adjusted historical results of Demandware for the nine months ended September 30, 2016 and 2015, due to differences in reporting periods and considering the date the Company acquired Demandware, and the effects of the pro forma adjustments described above.

**SteelBrick**

In February 2016, the Company acquired the outstanding stock of SteelBrick, Inc. ("SteelBrick") for consideration consisting of cash and common stock. SteelBrick is a next generation quote-to-cash platform, delivered 100 percent natively on the Salesforce platform, which offers applications, or apps, for automating the entire deal close process - from generating quotes and configuring orders to collecting cash. The Company has included the financial results of SteelBrick in the consolidated financial statements from the date of acquisition, which have not been material to date. The transaction costs associated with the acquisition were not material.

The acquisition date fair value consideration transferred for SteelBrick was approximately \$314.8 million, which consisted of the following (in thousands, except for share data):

	Fair Value
Cash	\$1,698
Common stock (4,288,447 shares)	278,372
Fair value of stock options and restricted stock awards assumed	10,989
Fair value of pre-existing relationship	23,726
Total	\$314,785

The fair value of stock options assumed by the Company was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.08 was applied to convert SteelBrick's outstanding equity awards for SteelBrick's common stock into equity awards for shares of the Company's common stock.

The Company had a \$13.9 million, or approximately six percent, noncontrolling equity investment in SteelBrick prior to the acquisition. The acquisition date fair value of the Company's previously held equity interest was approximately \$23.7 million and is included in the measurement of the consideration transferred. The Company recognized a gain of approximately \$9.8 million as a result of remeasuring its prior equity interest in SteelBrick held before the business combination. The gain is included in gains on sales of strategic investments on the consolidated statement of operations.



Table of Contents

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition (in thousands):

	Fair Value
Cash and cash equivalents	\$59,296
Other current and noncurrent tangible assets	3,012
Customer contract asset, noncurrent	6,954
Intangible assets	49,160
Goodwill	217,986
Deferred revenue, current and noncurrent	(8,479 )
Other liabilities, current and noncurrent	(2,665 )
Deferred tax liability	(10,479 )
Net assets acquired	\$314,785

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible assets acquired, liabilities assumed and identifiable intangible assets are based on management's estimates and assumptions.

The following table sets forth the components of identifiable intangible assets acquired (in thousands) and their estimated useful lives as of the date of acquisition.

	Fair Value	Useful Life
Developed technology	\$30,700	4 years
Customer relationships	17,110	7 years
Other purchased intangible assets	1,350	1 year
Total intangible assets subject to amortization	\$49,160	

The amount recorded for developed technology represents the estimated fair value of SteelBrick's quote-to-cash and billing technology. The amount recorded for customer relationships represents the fair values of the underlying relationship with SteelBrick customers. The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating SteelBrick's quote-to-cash technology with the Company's other offerings. The majority of the goodwill balance is not deductible for U.S. income tax purposes.

The Company assumed equity awards for shares of SteelBrick's common stock with a fair value of \$39.6 million, of which \$11.0 million was allocated to the consideration transferred.

**MetaMind**

In April 2016, the Company acquired MetaMind, Inc. ("MetaMind") for approximately \$32.8 million in cash, net of cash acquired. This amount includes amounts to be paid after an initial holdback period, and assumed equity awards. The primary reason for the acquisition was to extend the Company's intelligence in natural language processing and image recognition across all clouds. The Company has included the financial results of MetaMind, which have not been material to date, in its consolidated financial statements from the date of acquisition. The transaction costs associated with the acquisition were not material. In allocating the purchase consideration for MetaMind based on estimated fair values, the Company recorded \$31.2 million of goodwill. The goodwill balance is not deductible for U.S. income tax purposes. The estimated fair values of assets acquired and liabilities assumed, specifically current and noncurrent income taxes payable and deferred taxes, may be subject to change as additional information is received and certain tax returns are finalized. Thus, the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The Company assumed equity awards for shares of MetaMind's common stock with a fair value of \$5.5 million, of which \$0.5 million was allocated to the purchase consideration.

The Company's chairman, who held a greater than ten percent ownership interest in MetaMind, received approximately \$6.0 million in total proceeds, subject to customary escrow amounts, in connection with this acquisition.



Table of Contents

## Other Business Combinations

During the nine months ended October 31, 2016, the Company acquired six other companies for an aggregate of \$96.7 million in cash, net of cash acquired, and has included the financial results of these companies in its consolidated financial statements from the respective dates of acquisition. These transactions, individually and in the aggregate, are not material to the Company. The costs associated with these acquisitions were not material. The Company accounted for these transactions as business combinations. In allocating the purchase consideration for each company based on estimated fair values, the Company recorded \$100.4 million of goodwill. The goodwill balance associated with these transactions is not deductible for U.S. income tax purposes. The Company expects to finalize the valuations as soon as practicable, but not later than one year from the acquisition dates.

## 5. Debt

## Convertible Senior Notes

(in thousands)	Par Value Outstanding	Equity Component Recorded at Issuance	Liability Component of Par Value as of	
			October 31, 2016	January 31, 2016
0.25% Convertible Senior Notes due April 1, 2018	\$ 1,150,000	\$ 122,421	(1)\$ 1,109,236	\$ 1,088,097

(1) This amount represents the equity component recorded at the initial issuance of the 0.25% convertible senior notes.

In March 2013, the Company issued at par value \$1.15 billion of 0.25% convertible senior notes (the “0.25% Senior Notes”, or the “Notes”) due April 1, 2018, unless earlier purchased by the Company or converted. Interest is payable semi-annually, in arrears on April 1 and October 1 of each year.

The 0.25% Senior Notes are governed by an indenture between the Company, as issuer, and U.S. Bank National Association, as trustee. The 0.25% Senior Notes are unsecured and do not contain any financial covenants or any restrictions on the payment of dividends, the incurrence of senior debt or other indebtedness, or the issuance or repurchase of securities by the Company.

If converted, holders of the 0.25% Senior Notes will receive cash equal to the principal amount, and at the Company’s election, cash, shares of the Company’s common stock, or a combination of cash and shares, for any amounts in excess of the principal amounts.

Certain terms of the conversion features of the 0.25% Senior Notes are as follows:

Conversion Rate per \$1,000 Par Value	Initial Conversion Price per Share	Convertible Date
0.25% Senior Notes 15.0512	\$ 66.44	January 1, 2018

Throughout the term of the 0.25% Senior Notes, the conversion rate may be adjusted upon the occurrence of certain events, including any cash dividends. Holders of the 0.25% Senior Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Accrued but unpaid interest will be deemed to be paid in full upon conversion rather than canceled, extinguished or forfeited.

Holders may convert the 0.25% Senior Notes under the following circumstances:

- during any fiscal quarter, if, for at least 20 trading days during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sales price of the Company’s common stock for such trading day is greater than or equal to 130% of the applicable conversion price on such trading day;
- in certain situations, when the trading price of the 0.25% Senior Notes is less than 98% of the product of the sale price of the Company’s common stock and the conversion rate;
- upon the occurrence of specified corporate transactions described under the 0.25% Senior Notes indenture, such as a consolidation, merger or binding share exchange; or
- at any time on or after the convertible date noted above.

Holders of the 0.25% Senior Notes have the right to require the Company to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, such as a change of control, at a purchase price equal to 100% of the

29

---



Table of Contents

principal amount of the 0.25% Senior Notes plus accrued and unpaid interest. Following certain corporate transactions that constitute a change of control, the Company will increase the conversion rate for a holder who elects to convert the 0.25% Senior Notes in connection with such change of control.

In accounting for the issuances of the 0.25% Senior Notes, the Company separated the 0.25% Senior Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the 0.25% Senior Notes as a whole. The excess of the principal amount of the liability component over its carrying amount (“debt discount”) is amortized to interest expense over the term of the 0.25% Senior Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. In accounting for the transaction costs related to the 0.25% Senior Notes issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Transaction costs attributable to the liability component are being amortized to expense over the terms of the 0.25% Senior Notes, and transaction costs attributable to the equity component were netted with the equity component in temporary stockholders’ equity and stockholders’ equity.

The 0.25% Senior Notes consisted of the following (in thousands):

	As of October 31, 2016	January 31, 2016
Liability component :		
Principal (1)	\$1,150,000	\$1,150,000
Less: debt discount, net (2)	(36,260 )	(54,941 )
Less: debt issuance cost (3)	(4,504 )	(6,962 )
Net carrying amount	\$1,109,236	\$1,088,097

(1)The effective interest rate of the 0.25% Senior Notes is 2.53%. The interest rate is based on the interest rates of similar liabilities at the time of issuance that did not have an associated convertible feature.

(2)Included in the consolidated balance sheets within Convertible 0.25% Senior Notes (which is classified as a noncurrent liability) and is amortized over the life of the 0.25% Senior Notes using the effective interest rate method.

(3)In April 2015, the FASB issued ASU 2015-03 which simplifies the presentation of debt issuance costs by requiring debt issuance costs to be presented as a deduction from the corresponding debt liability rather than an asset that is amortized. The Company retrospectively adopted this standard for the prior period presented.

The total estimated fair value of the Company's 0.25% Senior Notes at October 31, 2016 was \$1.4 billion. The fair value was determined based on the closing trading price per \$100 of the 0.25% Senior Notes as of the last day of trading for the third quarter of fiscal 2017.

Based on the closing price of the Company’s common stock of \$75.16 on October 31, 2016, the if-converted value of the 0.25% Senior Notes exceeded their principal amount by approximately \$150.9 million. Based on the terms of the 0.25% Senior Notes, the Senior Notes were not convertible for the three and nine months ended October 31, 2016.

#### Note Hedges

To minimize the impact of potential economic dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock (the “0.25% Note Hedges”).

(in thousands, except for shares)	Date	Purchase	Shares
0.25% Note Hedges	March 2013	\$153,800	17,308,880

The 0.25% Note Hedges cover shares of the Company’s common stock at a strike price that corresponds to the initial conversion price of the 0.25% Senior Notes, also subject to adjustment, and are exercisable upon conversion of the Notes. The 0.25% Note Hedges will expire upon the maturity of the 0.25% Senior Notes. The 0.25% Note Hedges are intended to reduce the potential economic dilution upon conversion of the 0.25% Senior Notes in the event that the market value per share of the Company’s common stock, as measured under the 0.25% Senior Notes, at the time of

exercise is greater than the conversion price of the 0.25% Senior Notes. The 0.25% Note Hedges are separate transactions and are not part of the terms of the 0.25%

Table of Contents

Senior Notes. Holders of the 0.25% Senior Notes will not have any rights with respect to the 0.25% Note Hedges. The 0.25% Note Hedges do not impact earnings per share.

## Warrants

	Date	Proceeds (in thousands)	Shares	Strike Price
0.25% Warrants	March 2013	\$ 84,800	17,308,880	\$90.40

In March 2013, the Company also entered into a warrants transaction (the “0.25% Warrants”), whereby the Company sold warrants to acquire, subject to anti-dilution adjustments, shares of the Company’s common stock. The 0.25% Warrants were anti-dilutive for the periods presented. The 0.25% Warrants are separate transactions entered into by the Company and are not part of the terms of the 0.25% Senior Notes or the 0.25% Note Hedges. Holders of the 0.25% Senior Notes and 0.25% Note Hedges will not have any rights with respect to the 0.25% Warrants.

## Term Loan

In July 2016, the Company entered into a credit agreement (the “Term Loan Credit Agreement”) with Bank of America, N.A. and certain other institutional lenders for a \$500.0 million term loan facility (the “Term Loan”) that matures on July 11, 2019. The Term Loan will bear interest, at the Company’s option, at either a base rate plus a spread of 0.00% to 0.75% or an adjusted LIBOR rate plus a spread of 1.00% to 1.75%, in each case with such spread being determined based on the Company’s consolidated leverage ratio for the preceding four fiscal quarter period.

In July 2016, the Company borrowed the full \$500.0 million under the Term Loan. All of the net proceeds of the Term Loan were for the purposes of partially funding the acquisition of Demandware.

Interest on the Term Loan is due and payable in arrears quarterly for loans bearing interest at a rate based on the base rate and at the end of an interest period in the case of loans bearing interest at the adjusted LIBOR rate.

All outstanding amounts under the Term Loan Credit Agreement will be due and payable on July 11, 2019. The Company may prepay the Term Loan, in whole or in part, at any time without premium or penalty, subject to certain conditions, and amounts repaid or prepaid may not be reborrowed. The Company’s obligations under the Term Loan Credit Agreement are required to be guaranteed by certain of its subsidiaries meeting certain thresholds set forth in the Term Loan Credit Agreement.

The Term Loan Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries’ ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends or make distributions and repurchase stock. The Company is also required to maintain compliance with a consolidated leverage ratio and a consolidated interest coverage ratio. The Term Loan Credit Agreement includes customary events of default. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Term Loan Credit Agreement at a per annum rate equal to 2.00% above the applicable interest rate for any overdue principal and 2.00% above the rate applicable for base rate loans for any other overdue amounts. The occurrence of an event of default could result in the acceleration of obligations under the Term Loan Credit Agreement. The Company was in compliance with the Term Loan Credit Agreement’s covenants as of October 31, 2016.

The weighted average interest rate on the Term Loan was 1.8% as of October 31, 2016. Accrued interest on the Term Loan was \$2.8 million as of October 31, 2016. As of October 31, 2016, the noncurrent outstanding principal portion was \$500.0 million.

## Revolving Credit Facility

In July 2016, the Company entered into an Amended and Restated Credit Agreement (the “Revolving Loan Credit Agreement”) with Wells Fargo Bank, National Association, and certain other institutional lenders that provides for \$1.0 billion unsecured revolving credit facility (the “Credit Facility”) that matures in July 2021. The Revolving Loan Credit Agreement amended and restated the Company’s existing revolving credit facility dated October 2014. The Company may use the proceeds of future borrowings under the Credit Facility for refinancing other indebtedness, working capital, capital expenditures and other general corporate purposes, including permitted acquisitions.

The borrowings under the Credit Facility bear interest, at the Company’s option, at a base rate plus a spread of 0.00% to 0.75% or an adjusted LIBOR rate plus a spread of 1.00% to 1.75%, in each case with such spread being determined

based on the Company's consolidated leverage ratio for the preceding four fiscal quarter period. Interest is due and payable in arrears

31

---

Table of Contents

quarterly for loans bearing interest at a rate based on the base rate and at the end of an interest period in the case of loans bearing interest at the adjusted LIBOR rate. Regardless of what amounts, if any, are outstanding under the Credit Facility, the Company is also obligated to pay an ongoing commitment fee at a rate of 0.125% to 0.25%, with such rate being based on the Company's consolidated leverage ratio for the preceding four fiscal quarter period, payable in arrears quarterly.

The Revolving Loan Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries' ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends or make distributions and repurchase stock. The Company is also required to maintain compliance with a consolidated leverage ratio and a consolidated interest coverage ratio. The Revolving Loan Credit Agreement includes customary events of default. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Revolving Loan Credit Agreement at a per annum rate equal to 2.00% above the applicable interest rate for any overdue principal and 2.00% above the rate applicable for base rate loans for any other overdue amounts. The occurrence of an event of default could result in the acceleration of obligations under the Revolving Loan Credit Agreement. The Company was in compliance with the Revolving Loan Credit Agreement's covenants as of October 31, 2016.

There were no outstanding borrowings under the Credit Facility as of October 31, 2016. The Company continues to pay a commitment fee on the undrawn amount of the Credit Facility. In November 2016, the Company borrowed \$750.0 million under the Credit Facility, in part to fund the acquisition of Krux Digital, Inc. See Note 13 "Subsequent Events."

Loan Assumed on 50 Fremont

The Company assumed a \$200.0 million loan with the acquisition of 50 Fremont (the "Loan"). The Loan bears an interest rate of 3.75% per annum and is due in June 2023. The Loan initially requires interest only payments. Beginning in fiscal year 2019, principal and interest payments are required, with the remaining principal due at maturity. For the three months ended October 31, 2016 and 2015, total interest expense recognized was \$1.8 million and \$1.9 million, respectively. For the nine months ended October 31, 2016 and 2015, total interest expense recognized was \$5.6 million and \$5.4 million, respectively. The Loan can be prepaid at any time subject to a yield maintenance fee. The agreement governing the Loan contains certain customary affirmative and negative covenants that the Company was in compliance with as of October 31, 2016.

Interest Expense on Convertible Senior Notes, Term Loan, Revolving Credit Facility and Loan Assumed on 50 Fremont

The following table sets forth total interest expense recognized related to the 0.25% Senior Notes, the Term Loan, the Credit Facility and the Loan prior to capitalization of interest (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Contractual interest expense	\$5,207	\$2,843	\$11,398	\$9,036
Amortization of debt issuance costs	1,342	1,027	4,071	3,077
Amortization of debt discount	6,304	6,148	18,794	18,317
	\$12,853	\$10,018	\$34,263	\$30,430

Table of Contents

## 6. Other Balance Sheet Accounts

## Prepaid Expenses and Other Current Assets

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

	As of	
	October 31,	January 31,
	2016	2016
Prepaid income taxes	\$22,766	\$ 22,044
Customer contract asset (1)	0	1,423
Other taxes receivable	25,829	27,341
Prepaid expenses and other current assets	232,998	199,786
	\$281,593	\$ 250,594

(1) As of October 31, 2016, the customer contract asset has been presented as a long term intangible asset. For further information see Note 4 "Business Combinations."

## Capitalized Software, net

Capitalized software consisted of the following (in thousands):

	As of	
	October 31,	January 31,
	2016	2016
Capitalized internal-use software development costs, net of accumulated amortization of \$233,706 and \$186,251, respectively	\$137,989	\$ 123,065
Acquired developed technology, net of accumulated amortization of \$571,023 and \$481,118, respectively	499,888	261,193
	\$637,877	\$ 384,258

Capitalized internal-use software amortization expense totaled \$16.6 million and \$12.9 million for the three months ended October 31, 2016 and 2015, respectively and totaled \$47.5 million and \$36.4 million for the nine months ended October 31, 2016 and 2015, respectively. Acquired developed technology amortization expense totaled \$38.4 million and \$22.1 million for the three months ended October 31, 2016 and 2015, respectively and totaled \$89.9 million and \$66.5 million for the nine months ended October 31, 2016 and 2015, respectively.

The Company capitalized \$1.7 million and \$1.3 million of stock-based expenses related to capitalized internal-use software development during the three months ended October 31, 2016 and 2015, respectively, and \$5.1 million and \$4.4 million for the nine months ended October 31, 2016 and 2015, respectively.

Table of Contents

## Goodwill

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill amounts are not amortized, but rather tested for impairment at least annually during the fourth quarter.

Goodwill consisted of the following (in thousands):

Balance as of January 31, 2016	\$3,849,937
SteelBrick	217,986
MetaMind	31,242
Demandware	1,884,886
Quip	357,610
BeyondCore	90,794
Other business combinations	100,389
Adjustments of acquisition date fair values:	
SteelBrick	651
Demandware	100,383
Other business combinations	(16,879 )
Balance as of October 31, 2016	\$6,616,999

Other Assets, net

Other assets consisted of the following (in thousands):

	As of	
	October 31, 2016	January 31, 2016
Deferred income taxes, noncurrent, net	\$22,095	\$ 15,986
Long-term deposits	25,346	19,469
Purchased intangible assets, net of accumulated amortization of \$281,846 and \$212,248, respectively	622,667	258,580
Acquired intellectual property, net of accumulated amortization of \$27,331 and \$22,439, respectively	11,122	10,565
Customer contract asset, noncurrent (1)	308,484	93
Other (2)	110,722	66,217
	\$1,100,436	\$ 370,910

(1) As of October 31, 2016, the customer contract asset has been presented as a long term intangible asset. For further information see Note 4 "Business Combinations."

(2) In April 2015, the FASB issued ASU 2015-03 which simplifies the presentation of debt issuance costs by requiring debt issuance costs to be presented as a deduction from the corresponding debt liability rather than an asset that is amortized. The Company retrospectively adopted this standard for the prior period presented, which resulted in a decrease in the carrying value of \$7.9 million to Other as of January 31, 2016.

Purchased intangible assets amortization expense for the three months ended October 31, 2016 and 2015 was \$29.3 million and \$20.1 million, respectively and for the nine months ended October 31, 2016 and 2015 was \$69.6 million and \$60.8 million, respectively. Acquired intellectual property amortization expense for the three months ended October 31, 2016 and 2015 was \$1.6 million and \$1.7 million, respectively and for the nine months ended October 31, 2016 and 2015 was \$4.9 million and \$5.1 million, respectively.

Table of Contents

## Accounts Payable, Accrued Expenses and Other Liabilities

Accounts payable, accrued expenses and other liabilities consisted of the following (in thousands):

	As of	
	October 31, 2016	January 31, 2016
Accounts payable	\$140,541	\$71,481
Accrued compensation	558,945	554,502
Non-cash equity liability (1)	74,570	0
Accrued other liabilities	498,774	447,729
Accrued income and other taxes payable	149,133	205,781
Accrued professional costs	38,331	33,814
Customer contract liability (2)	0	6,558
Accrued rent	17,055	14,071
Financing obligation - leased facility, current (3)	19,492	15,402
	\$1,496,841	\$1,349,338

## Other Noncurrent Liabilities

Other noncurrent liabilities consisted of the following (in thousands):

	As of	
	October 31, 2016	January 31, 2016
Deferred income taxes and income taxes payable	\$93,454	\$85,996
Customer contract liability, noncurrent (2)	0	66
Financing obligation - leased facility (3)	201,283	196,711
Long-term lease liabilities and other	490,550	550,292
	\$785,287	\$833,065

(1) Non-cash equity liability represents the purchase price of shares issued to non-executive employees, as to shares exceeding previously registered ESPP shares at the time of sale to the extent the shares had not been subsequently sold by the employee purchaser. The Company expects this liability will be relieved within a year or earlier as the shares are subsequently sold.

(2) As of October 31, 2016, the customer contract liability has been presented as part of the customer contract asset. For further information see Note 4 "Business Combinations."

(3) As of January 31, 2016, 350 Mission was in construction. In March 2016, construction was completed on the building. See Note 3 "Property and Equipment" for further discussion.



Table of Contents

## 7. Stockholders' Equity

The Company maintains the following stock plans: the ESPP, the 2013 Equity Incentive Plan and the 2014 Inducement Equity Incentive Plan (the "2014 Inducement Plan"). The expiration of the 1999 Stock Option Plan ("1999 Plan") in fiscal 2010 did not affect awards outstanding, which continue to be governed by the terms and conditions of the 1999 Plan.

As of October 31, 2016, \$96.3 million has been withheld on behalf of employees for future purchases under the ESPP and is recorded in accounts payable, accrued expenses and other liabilities.

Prior to February 1, 2006, options issued under the Company's stock option plans generally had a term of 10 years. From February 1, 2006 through July 2013, options issued had a term of five years. After July 2013, options issued have a term of seven years.

During fiscal 2016, the Company granted a performance-based restricted stock unit award to the Chairman of the Board and Chief Executive Officer subject to vesting based on a performance-based condition and a service-based condition. At the end of the three year service period based on the Company's share price performance, as it relates to the performance condition, these performance-based restricted stock units will vest simultaneously.

Stock activity excluding the ESPP is as follows:

	Shares Available for Grant	Options Outstanding	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2016	46,879,908	26,258,798	\$ 56.26	
Increase in shares authorized:				
2013 Equity Incentive Plan	185,247			
2014 Inducement Plan	2,280,899			
Assumed equity plans	3,490,475			
Options granted under all plans	(3,048,797 )	3,048,797	43.26	
Restricted stock activity	(7,894,898 )			
Stock grants to board and advisory board members	(151,665 )			
Exercised	0	(4,310,671 )	36.84	
Plan shares expired	(75,193 )			
Canceled	1,074,951	(1,074,951 )	65.99	
Balance as of October 31, 2016	42,740,927	23,921,973	\$ 57.67	\$ 452,870
Vested or expected to vest		22,290,560	\$ 56.96	\$ 435,630
Exercisable as of October 31, 2016		9,738,925	\$ 46.81	\$ 276,132

The total intrinsic value of the options exercised during the nine months ended October 31, 2016 and 2015 was \$176.2 million and \$251.3 million, respectively. The intrinsic value is the difference between the current market value of the stock and the exercise price of the stock option.

The weighted-average remaining contractual life of vested and expected to vest options is approximately 4.8 years.

As of October 31, 2016, options to purchase 9,738,925 shares were vested at a weighted average exercise price of \$46.81 per share and had a remaining weighted-average contractual life of approximately 3.6 years. The total intrinsic value of these vested options as of October 31, 2016 was \$276.1 million.

Table of Contents

The following table summarizes information about stock options outstanding as of October 31, 2016:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
\$0.86 to \$39.09	4,967,743	3.3	\$ 27.75	3,787,491	\$ 32.10
\$40.19 to \$52.28	367,386	3.6	44.03	238,650	43.74
\$52.30	3,511,561	4.1	52.30	2,402,677	52.30
\$53.60 to \$58.86	1,060,744	4.7	55.56	406,859	55.79
\$59.34	5,779,049	5.1	59.34	2,565,609	59.34
\$59.37 to \$80.62	2,729,211	6.1	71.03	337,639	68.78
\$80.99 to \$82.55	5,506,279	6.1	81.02	0	0.00
	23,921,973	4.8	\$ 57.67	9,738,925	\$ 46.81

Restricted stock activity is as follows:

	Restricted Stock Outstanding		
	Outstanding	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2016	21,294,585	\$ 0.001	
Granted- restricted stock units and awards	6,890,113	0.001	
Canceled	(1,539,907)	0.001	
Vested and converted to shares	(5,310,841)	0.001	
Balance as of October 31, 2016	21,333,950	\$ 0.001	\$ 1,603,460
Expected to vest	18,310,081		\$ 1,376,186

The restricted stock, which upon vesting entitles the holder to one share of common stock for each share of restricted stock, has an exercise price of \$0.001 per share, which is equal to the par value of the Company's common stock, and generally vests over 4 years.

The weighted-average grant date fair value of the restricted stock issued for the nine months ended October 31, 2016 and 2015 was \$76.90 and \$70.26, respectively.

#### Common Stock

The following number of shares of common stock were reserved and available for future issuance at October 31, 2016:

Options outstanding	23,921,973
Restricted stock awards and units and performance stock units outstanding	21,333,950
Stock available for future grant:	
2013 Equity Incentive Plan	41,903,116
2014 Inducement Plan	755,404
Amended and Restated 2004 Employee Stock Purchase Plan	5,289,597
Acquired equity plans	82,407
Convertible Senior Notes	17,308,880
Warrants	17,308,880
	127,904,207



Table of Contents

## 8. Income Taxes

## Effective Tax Rate

The Company computes its year-to-date provision for income taxes by applying the estimated annual effective tax rate to year to date pretax income or loss and adjusts the provision for discrete tax items recorded in the period. For the nine months ended October 31, 2016, the Company reported a tax benefit of \$182.2 million on a pretax income of \$48.9 million, which resulted in a negative effective tax rate of 373 percent. The most significant component of this tax amount was the discrete tax benefit of \$205.6 million from a partial release of the valuation allowance in connection with the acquisition of Demandware. The net deferred tax liability from the acquisition of Demandware provided a source of additional income to support the realizability of the Company's pre-existing deferred tax assets and as a result, the Company released a portion of its valuation allowance. The tax benefit associated with the release of the valuation allowance was partially offset by income taxes in profitable jurisdictions outside of the United States. The Company regularly assesses the realizability of the deferred tax assets and establishes a valuation allowance if it is more-likely-than-not that some or all of the Company's deferred tax assets will not be realized. The Company evaluates and weighs all available positive and negative evidence such as historic results, future reversals of existing deferred tax liabilities, projected future taxable income, as well as prudent and feasible tax-planning strategies. Generally, more weight is given to objectively verifiable evidence, such as the cumulative loss in recent years. The Company adjusts its valuation allowance in the event sufficient positive evidence overcomes the negative evidence of losses in recent years, for example, if the trend in increasing taxable income continues.

As described in Note 1 "Summary of Business and Significant Accounting Policies," the Company early adopted ASU 2016-09 in the three months ended April 30, 2016. As a result of adopting ASU 2016-09 and the Company's current valuation allowance position, the Company did not record a current tax expense associated with the United States jurisdiction.

For the nine months ended October 31, 2015, the Company reported a tax provision of \$90.3 million on a pretax income of \$68.4 million, which resulted in an effective tax rate of 132 percent. The tax provision recorded was primarily related to income taxes in profitable jurisdictions outside the United States.

## Tax Benefits Related to Stock-Based Compensation

The income tax benefit related to stock-based compensation was \$161.4 million and \$130.8 million for the nine months ended October 31, 2016 and 2015, respectively, the majority of which was not recognized as a result of the valuation allowance.

## Unrecognized Tax Benefits and Other Considerations

The Company records liabilities related to its uncertain tax positions. Tax positions for the Company and its subsidiaries are subject to income tax audits by multiple tax jurisdictions throughout the world. Certain prior year tax returns are currently being examined by various taxing authorities in countries including the United States and France. During the nine months ended October 31, 2016, the Company effectively settled the uncertain tax positions subject to the audits in the United Kingdom and Canada, and as a result, the Company released the associated tax reserves. In addition, the Company reached a settlement with the taxing authority in Switzerland and recorded an insignificant amount to the tax provision as a result of the closure of the audit.

The Company believes that it has provided adequate reserves for its income tax uncertainties in all open tax years. However, the outcome of the tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner inconsistent with management's expectations, the Company could adjust its provision for income taxes in the future. However, in general, any adjustments resulting from the U.S. audits should not have an impact to our tax provision due to our valuation allowance. The Company anticipates it is reasonably possible that a decrease of unrecognized tax benefits up to approximately \$8.3 million may occur in the next 12 months, as the applicable statutes of limitations lapse.

Table of Contents

## 9. Earnings Per Share

Basic earnings/loss per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the fiscal period. Diluted earnings/loss per share is computed by giving effect to all potential weighted average dilutive common stock, including options, restricted stock units, warrants and the convertible senior notes. The dilutive effect of outstanding awards and convertible securities is reflected in diluted earnings per share by application of the treasury stock method. Diluted loss per share for the three months ended October 31, 2016 and the three and nine months ended October 31, 2015 is the same as basic loss per share as there is a net loss in the period and inclusion of potentially issuable shares is anti-dilutive

A reconciliation of the denominator used in the calculation of basic and diluted earnings per share is as follows (in thousands):

	Three Months Ended October 31, 2016		Nine Months Ended October 31, 2015	
Numerator:				
Net income (loss)	\$(37,309)	\$(25,157)	\$231,072	\$(21,917)
Denominator:				
Weighted-average shares outstanding for basic earnings (loss) per share	690,468	664,131	683,075	659,160
Effect of dilutive securities:				
Convertible senior notes	0	0	1,994	0
Employee stock awards	0	0	11,188	0
Adjusted weighted-average shares outstanding and assumed conversions for diluted earnings (loss) per share	690,468	664,131	696,257	659,160

The weighted-average number of shares outstanding used in the computation of diluted earnings per share does not include the effect of the following potential outstanding common stock. The effects of these potentially outstanding shares were not included in the calculation of diluted earnings per share because the effect would have been anti-dilutive (in thousands):

	Three Months Ended October 31, 2016		Nine Months Ended October 31, 2015	
Employee stock awards	17,946	20,191	8,640	22,634
Convertible senior notes	17,309	17,309	0	17,309
Warrants	17,309	17,309	17,309	17,309

Table of Contents

## 10. Commitments

## Letters of Credit

As of October 31, 2016, the Company had a total of \$84.0 million in letters of credit outstanding substantially in favor of certain landlords for office space. These letters of credit renew annually and expire at various dates through December 2030.

## Leases

The Company leases facilities space and certain fixed assets under non-cancelable operating and capital leases with various expiration dates.

As of October 31, 2016, the future minimum lease payments under non-cancelable operating and capital leases are as follows (in thousands):

	Capital Leases	Operating Leases	Financing Obligation -Leased Facility(1)
Fiscal Period:			
Remaining three months of fiscal 2017	\$26,431	\$109,755	\$5,322
Fiscal 2018	122,649	429,673	21,437
Fiscal 2019	115,791	382,264	21,881
Fiscal 2020	201,576	303,873	22,325
Fiscal 2021	35	264,798	22,770
Thereafter	0	1,445,905	233,927
Total minimum lease payments	466,482	\$2,936,268	\$327,662
Less: amount representing interest	(41,368)		
Present value of capital lease obligations	\$425,114		

(1) Total Financing Obligation -Leased Facility noted above represents the total obligation on the lease agreement including amounts allocated to interest noted in Note 3 "Property and Equipment." As of October 31, 2016, \$220.8 million of the total obligation noted above was recorded to Financing obligation - leased facility, of which the current portion is included in "Accounts payable, accrued expenses and other liabilities" and the non-current portion is included in "Other noncurrent liabilities" on the consolidated balance sheets.

The Company's agreements for the facilities and certain services provide the Company with the option to renew. The Company's future contractual obligations would change if the Company exercised these options.

The terms of the lease agreements provide for rental payments on a graduated basis. The Company recognizes rent expense on a straight-line basis over the lease period and has accrued for rent expense incurred but not paid. Of the total operating lease commitment balance of \$2.9 billion, approximately \$2.6 billion is related to facilities space. The remaining commitment amount is related to computer equipment and furniture and fixtures.

## Other Purchase Commitments

In April 2016, the Company entered into an agreement with a third party provider for certain infrastructure services for a period of four years. The agreement provides that the Company will pay \$35.0 million in the remainder of fiscal 2017, \$96.0 million in fiscal 2018, \$108.0 million in fiscal 2019 and \$126.0 million in fiscal 2020.

## 11. Legal Proceedings and Claims

In the ordinary course of business, the Company is or may be involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, corporate and securities, labor and employment, class actions, wage and hour, and other claims. The Company has been, and may in the future be put on notice and/or sued by third parties for alleged infringement of their proprietary rights, including patent infringement.

During fiscal 2015, the Company received a communication from a large technology company alleging that the Company infringed certain of its patents. No litigation has been filed to date. There can be no assurance that this claim will not lead to litigation in the future. The resolution of this claim is not expected to have a material adverse effect on the Company's financial condition, but it could be material to operating results or cash flows or both of a particular quarter.

40

---

Table of Contents

In general, the resolution of a legal matter could prevent the Company from offering its service to others, could be material to the Company's financial condition or cash flows, or both, or could otherwise adversely affect the Company's operating results.

The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In management's opinion, resolution of all current matters is not expected to have a material adverse impact on the Company's consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's future results of operations or cash flows, or both, of a particular quarter.

12. Related-Party Transactions

In January 1999, the Salesforce.com Foundation, also referred to as the Foundation, was chartered on an idea of leveraging the Company's people, technology, and resources to help improve communities around the world. The Company calls this integrated philanthropic approach the 1-1-1 model. Beginning in 2008, Salesforce.org, which is a non-profit public benefit corporation, was established to resell the Company's services to nonprofit organizations and certain higher education organizations.

The Company's chairman is the chairman of both the Foundation and Salesforce.org. The Company's chairman holds one of the three Foundation board seats. The Company's chairman, one of the Company's employees and one of the Company's board members hold three of Salesforce.org's nine board seats. The Company does not control the Foundation's or Salesforce.org's activities, and accordingly, the Company does not consolidate either of the related entities' statement of activities with its financial results.

Since the Foundation's and Salesforce.org's inception, the Company has provided at no charge certain resources to those entities employees such as office space, furniture, equipment, facilities, services, and other resources. The value of these items was approximately \$2.5 million for the nine months ended October 31, 2016.

The resource sharing agreement was amended in August 2015 to include resources outside of the United States and is more explicit about the types of resources that the Company will provide.

Additionally, the Company has donated subscriptions of the Company's services to other qualified non-profit organizations. The Company also allows Salesforce.org to resell the Company's service to non-profit organizations and certain education entities. The Company does not charge Salesforce.org for these subscriptions, therefore revenue from subscriptions provided to non-profit organizations is donated back to the community through charitable grants made by the Foundation and Salesforce.org. The reseller agreement was amended in August 2015 to include additional customer segments and certain customers outside the U.S. and in October 2015 to add an addendum with model clauses for the processing of personal data transferred from the European Economic Area. The value of the subscriptions pursuant to reseller agreements was approximately \$92.9 million for the nine months ended October 31, 2016. The Company plans to continue these programs.

As described in Note 4 "Business Combinations," the Company's chairman held an ownership interest in an acquisition that was completed by the Company in April 2016.

13. Subsequent Events

In November 2016, the Company acquired the outstanding stock of Krux Digital, Inc. ("Krux"), in exchange for cash funded from a portion of our Credit Facility and the issuance of shares of common stock of the Company. Krux is a leading data management platform that increases engagement with users, prospects and customers. The Company acquired Krux for its product offerings and employees. After taking into consideration customary purchase price adjustments, the total estimated consideration for Krux was approximately \$700.0 million.





Table of Contents

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Words such as “expects,” “anticipates,” “aims,” “projects,” “intends,” “plans,” “believes,” “estimates,” “seeks,” “assumes,” “may,” “should,” “could,” “would,” “foresees,” “forecasts,” “predicts,” “targets,” variations of such words and other expressions are intended to identify such forward-looking statements, which may consist of, among other things, trend analyses and statements regarding future events, future financial performance, anticipated growth and industry prospects. These forward-looking statements are based on current expectations, estimates and forecasts, as well as the beliefs and assumptions of our management, and are subject to risks and uncertainties that are difficult to predict, including the effect of general economic and market conditions; the impact of foreign currency exchange rate and interest rate fluctuations on our results; our business strategy and our plan to build our business, including our strategy to be the leading provider of enterprise cloud computing applications and platforms; our service performance and security; the expenses associated with new data centers and third party infrastructure providers; additional data center capacity; real estate and office facilities space; our operating results; new services and product features; our strategy of acquiring or making investments in complementary businesses, joint ventures, services, technologies and intellectual property rights; our ability to successfully integrate acquired businesses and technologies; our ability to continue to grow and maintain deferred revenue and unbilled deferred revenue; our ability to protect our intellectual property rights; our ability to develop our brands; our ability to realize the benefits from strategic partnerships and investments; our reliance on third- party hardware, software and platform providers; our dependency on the development and maintenance of the infrastructure of the Internet; the effect of evolving government regulations; the valuation of our deferred tax assets; the potential availability of additional tax assets in the future; the impact of new accounting pronouncements; the impact of expensing stock options and other equity awards; the sufficiency of our capital resources; factors related to our outstanding convertible notes, revolving credit facility, term loan and loan associated with 50 Fremont; compliance with our debt covenants and capital lease obligations; and current and potential litigation involving us. These and other risks and uncertainties may cause our actual results to differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified below under “Risk Factors” and elsewhere in this report for additional detail regarding factors that may cause actual results to be different than those expressed in our forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

## Overview

We are a leading provider of enterprise cloud computing solutions, with a focus on customer relationship management, or CRM. We introduced our first CRM solution in February 2000, and we have since expanded our service offerings with new editions, solutions, features and platform capabilities.

Our mission is to help our customers transform themselves into customer-centric companies by empowering them to connect with their customers in entirely new ways. Our Customer Success Platform includes, among other things, sales force automation, customer service and support, marketing automation, commerce, community management, analytics, application development, and Internet of Things (“IoT”) integration and our professional cloud services, provides the next-generation platform of enterprise applications, or apps, and services to enable customer success. We believe that the convergence of cloud, social, mobile, data science and IoT technologies is fundamentally transforming how companies sell, service, market and innovate to connect with their customers. With our service offerings —Sales Cloud, Service Cloud, Marketing Cloud, Commerce Cloud, Community Cloud, Analytics Cloud, IoT Cloud and App Cloud —customers have the tools they need to build a next generation customer success platform. Key elements of our strategy include:

- strengthening our market-leading solutions;
- expanding strategic relationships with customers;
- extending distribution into new and high-growth product categories;
- expanding our world-class sales organization;

reducing customer attrition;

42

---

Table of Contents

building our business in top software markets globally, which includes building partnerships that help add customers; and

encouraging the development of third-party applications on our cloud computing platforms.

We believe the factors that will influence our ability to achieve our objectives include: our prospective customers' willingness to migrate to enterprise cloud computing services; the availability, performance and security of our services; our ability to continue to release, and gain customer acceptance of, new and improved features; our ability to successfully integrate acquired businesses and technologies; successful customer adoption and utilization of our services; acceptance of our services in markets where we have few customers; the emergence of additional competitors in our market and improved product offerings by existing and new competitors; the location of new data centers; third-party developers' willingness to develop applications on our platforms; our ability to attract new personnel and retain and motivate current personnel; and general economic conditions which could affect our customers' ability and willingness to purchase our services, delay the customers' purchasing decision or affect attrition rates.

To address these factors, we will need to, among other things, continue to add substantial numbers of paying subscriptions, upgrade our customers to fully featured versions or arrangements such as an Enterprise License Agreement, provide high quality technical support to our customers, encourage the development of third-party applications on our platforms and continue to focus on retaining customers at the time of renewal. Our plans to invest for future growth include the continuation of the expansion of our data center capacity, the hiring of additional personnel, particularly in direct sales, other customer-related areas and research and development, the expansion of domestic and international selling and marketing activities, specifically in our top markets, continuing to develop our brands, the addition of distribution channels, the upgrade of our service offerings, the development of new services, the integration of acquired technologies, the expansion of our Marketing Cloud, Commerce Cloud and App Cloud core service offerings, and the additions to our global infrastructure to support our growth.

We also regularly evaluate acquisitions or investment opportunities in complementary businesses, joint ventures, services and technologies and intellectual property rights in an effort to expand our service offerings. We expect to continue to make such investments and acquisitions in the future and we plan to reinvest a significant portion of our incremental revenue in future periods to grow our business and continue our leadership role in the cloud computing industry. As a result of our aggressive growth plans, specifically our hiring plan and acquisition activities, we have incurred significant expenses from equity awards and amortization of purchased intangibles. As we continue with our growth plan and absent any one-time gains, we may continue to incur similar expenses in the future. We will continue to see headcount increases attributed to both our growth as well as the result of acquisitions.

Our typical subscription contract term is 12 to 36 months, although terms range from one to 60 months, so during any fiscal reporting period only a subset of active subscription contracts is eligible for renewal. We calculate our attrition rate as of the end of each month. Our current attrition rate calculation does not include the Marketing Cloud service offerings. Our attrition rate was between eight and nine percent as of October 31, 2016. We expect our attrition rate to remain consistent as we continue to expand our enterprise business and invest in customer success and related programs.

We expect marketing and sales costs, which were 46 percent and 49 percent for the nine months ended October 31, 2016 and 2015, respectively, to continue to represent a substantial portion of total revenues in the future as we seek to grow our customer base, sell more products to existing customers, and build greater brand awareness.

In July 2016 we acquired Demandware, Inc. ("Demandware"), an industry-leading provider of enterprise cloud commerce solutions in the digital commerce market. We acquired Demandware to expand our position in customer relationship management and to pursue the digital commerce market segment with the new Salesforce Commerce Cloud. The financial results of Demandware are included in our consolidated financial statements from the date of acquisition. As a result, our fluctuation analysis for our three and nine months ended October 31, 2016 compared to the same period in the prior year includes Demandware results. The total purchase price for Demandware was approximately \$2.9 billion.

In July 2016, we entered into a credit agreement (the "Term Loan Credit Agreement") which provides for a \$500.0 million term loan (the "Term Loan") that matures on July 11, 2019. All amounts borrowed under the Term Loan were

used to pay a portion of the total purchase price for Demandware. Additionally, we entered into an Amended and Restated Credit Agreement (the “Revolving Loan Credit Agreement”) with Wells Fargo Bank, National Association, and certain other institutional lenders that increased our existing revolving credit facility dated October 2014 to \$1.0 billion. As of October 31, 2016, there were no borrowings under the revolving credit facility. Subsequent to October 31, 2016, we borrowed \$750.0 million under the Credit Facility to partially fund the Krux Digital, Inc. (“KruX”) acquisition in November 2016 and for general corporate purposes.

43

---

## Table of Contents

In August 2016, we acquired the outstanding stock of Quip, Inc. (“Quip”). Quip combines content and communication to create living documents to allow work-teams to write, edit and discuss documents, spreadsheets and checklists in a single experience. The total purchase price for Quip was approximately \$412.0 million.

### Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2017, for example, refer to the fiscal year ending January 31, 2017.

### Operating Segments

We operate as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, who in our case is the chief executive officer, in deciding how to allocate resources and assess performance. Over the past few years, including fiscal 2017, we have completed a number of acquisitions. These acquisitions have allowed us to expand our offerings, presence and reach in various market segments of the enterprise cloud computing market. While we have offerings in multiple enterprise cloud computing market segments, including as a result of our acquisitions, our business operates in one operating segment because the majority of our offerings operate on a single platform and are deployed in an identical way, and our chief operating decision maker evaluates our financial information and resources and assesses the performance of these resources on a consolidated basis. Since we operate as one operating segment, all required financial segment information can be found in the consolidated financial statements.

### Sources of Revenues

We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers paying for additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue. “Other revenue” consists primarily of training fees. Subscription and support revenues accounted for approximately 93 percent of our total revenues for the nine months ended October 31, 2016. Subscription revenues are driven primarily by the number of paying subscribers, varying service types, the price of our service and renewals. We define a “customer” as a separate and distinct buying entity (e.g., a company, a distinct business unit of a large corporation, a partnership, etc.) that has entered into a contract to access our enterprise cloud computing services. We define a “subscription” as a unique user account purchased by a customer for use by its employees or other customer-authorized users, and we refer to each such user as a “subscriber.” The number of paying subscriptions at each of our customers ranges from one to hundreds of thousands. None of our customers accounted for more than five percent of our revenues during the nine months ended October 31, 2016 and 2015.

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement dates of each contract. The typical subscription and support term is 12 to 36 months, although terms range from one to 60 months. Our subscription and support contracts are non-cancelable, though customers typically have the right to terminate their contracts for cause if we materially fail to perform. We generally invoice our customers in advance, in annual installments, and typical payment terms provide that our customers pay us within 30 days of invoice. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue, or in revenue depending on whether the revenue recognition criteria have been met. In general, we collect our billings in advance of the subscription service period.

Professional services and other revenues consist of fees associated with consulting and implementation services and training. Our consulting and implementation engagements are billed on either a time and materials or fixed fee basis. We also offer a number of training classes on implementing, using and administering our service that are billed on a per person, per class basis. Our typical professional services payment terms provide that our customers pay us within 30 days of invoice.

In determining whether professional services can be accounted for separately from subscription and support revenues, we consider a number of factors, which are described in “Critical Accounting Estimates—Revenue Recognition” below.

Table of Contents

## Revenue by Cloud Service Offering

We are providing the information below on a supplemental basis to give additional insight into the revenue performance of our individual core service offerings. Subscription and support revenues consisted of the following by core service offering (in millions):

	Three Months Ended October 31,			Nine Months Ended October 31,		
	2016	2015	Variance- Percent	2016	2015	Variance- Percent
Sales Cloud	\$ 776.2	\$ 688.7	13%	\$ 2,255.7	\$ 1,990.1	13%
Service Cloud	589.9	469.5	26%	1,705.4	1,322.4	29%
App Cloud and Other	370.7	269.1	38%	1,050.0	740.4	42%
Marketing Cloud	247.2	169.0	46%	634.5	470.1	35%
Total	\$ 1,984.0	\$ 1,596.3		\$ 5,645.6	\$ 4,523.0	

Subscription and support revenues from the Analytics Cloud, Community Cloud, IoT Cloud and Commerce Cloud were not significant for the three and nine months ended October 31, 2016. Analytics Cloud revenue is included with App Cloud and Other in the table above. Community Cloud revenue is included in either Sales Cloud, Service Cloud or App Cloud and Other revenue depending on the primary service offering purchased. Commerce Cloud revenue, resulting from our Demandware acquisition in July 2016, is included in Marketing Cloud. As required under US GAAP, we recorded deferred revenue related to acquired contracts from Demandware at fair value. As a result, we did not recognize certain revenues related to these acquired contracts that Demandware would have otherwise recorded as an independent entity. Of the \$247.2 million subscription and support revenue for Marketing Cloud for third quarter of fiscal year 2017, approximately 17 percent was attributed to our Demandware acquisition. To the extent Demandware contracts are renewed following the acquisition, we will recognize the revenues for the full values of the contracts over the respective contractual periods.

In situations where a customer purchases multiple cloud offerings, such as through an Enterprise License Agreement, we allocate the contract value to each core service offering based on the customer's estimated product demand plan and the service that was provided at the inception of the contract. We do not update these allocations based on actual product usage during the term of the contract. We have allocated approximately 12 percent of our total subscription and support revenues for the three and nine months ended October 31, 2016 and 10 percent of our total subscription and support revenues for the three and nine months ended October 31, 2015, based on customers' estimated product demand plans and these allocated amounts are included in the table above.

Additionally, some of our service offerings have similar features and functions. For example, customers may use the Sales Cloud, the Service Cloud or our App Cloud to record account and contact information, which are similar features across these core service offerings. Depending on a customer's actual and projected business requirements, more than one core service offering may satisfy the customer's current and future needs. We record revenue based on the individual products ordered by a customer, and not according to the customer's business requirements and usage. In addition, as we introduce new features and functions within each offering, and refine our allocation methodology for changes in our business, we do not expect it to be practical to adjust historical revenue results by service offering for comparability. Accordingly, comparisons of revenue performance by core service offering over time may not be meaningful.

Our Sales Cloud service offering is our most widely distributed service offering and has historically been the largest contributor of subscription and support revenues. As a result, Sales Cloud has the most international exposure and foreign exchange rate exposure, relative to the other cloud service offerings. Conversely, revenue for Marketing Cloud is primarily derived from the Americas, with little impact from foreign exchange rate movement.

The revenue growth rates of each of our core service offerings fluctuate from quarter to quarter and over time. While we are a market leader in each core offering, we manage the total balanced product portfolio to deliver solutions to our customers. Accordingly, the revenue result for each cloud service offering is not necessarily indicative of the results to be expected for any subsequent quarter.





Table of Contents

## Seasonal Nature of Deferred Revenue, Accounts Receivable and Operating Cash Flow

Deferred revenue primarily consists of billings to customers for our subscription service. Over 90 percent of the value of our billings to customers is for our subscription and support service. We generally invoice our customers in annual cycles. Approximately 80 percent of the value of all subscription and support related invoices, excluding Demandware related invoices, were issued with annual terms during the three months ended October 31, 2016 in comparison to 79 percent during the same period a year ago. Occasionally, we bill customers for their multi-year contract on a single invoice which results in an increase in noncurrent deferred revenue. We typically issue renewal invoices in advance of the renewal service period, and depending on timing, the initial invoice for the subscription and services contract and the subsequent renewal invoice may occur in different quarters. This may result in an increase in deferred revenue and accounts receivable. There is a disproportionate weighting towards annual billings in the fourth quarter, primarily as a result of large enterprise account buying patterns. Our fourth quarter has historically been our strongest quarter for new business and renewals. The year on year compounding effect of this seasonality in both billing patterns and overall new and renewal business causes the value of invoices that we generate in the fourth quarter for both new business and renewals to increase as a proportion of our total annual billings. Accordingly, because of this billing activity, our first quarter is our largest collections and operating cash flow quarter.

The sequential quarterly changes in accounts receivable and the related deferred revenue and operating cash flow during the first quarter of our fiscal year are not necessarily indicative of the billing activity that occurs for the following quarters as displayed below (in thousands, except unbilled deferred revenue):

	April 30, 2016	July 31, 2016	October 31, 2016	
Fiscal 2017				
Accounts receivable, net	\$1,192,965	\$1,323,114	\$1,281,425	
Deferred revenue, current and noncurrent	4,006,914	3,823,561	3,495,133	
Operating cash flow (1)	1,051,062	250,678	154,312	
Unbilled deferred revenue (2)	7.6 bn	8.0 bn	8.6 bn	
	April 30, 2015	July 31, 2015	October 31, 2015	January 31, 2016
Fiscal 2016				
Accounts receivable, net	\$926,381	\$1,067,799	\$1,060,726	\$2,496,165
Deferred revenue, current and noncurrent	3,056,820	3,034,991	2,846,510	4,291,553
Operating cash flow (1)	735,081	304,278	162,514	470,208
Unbilled deferred revenue	6.0 bn	6.2 bn	6.7 bn	7.1 bn
	April 30, 2014	July 31, 2014	October 31, 2014	January 31, 2015
Fiscal 2015				
Accounts receivable, net	\$684,155	\$834,323	\$794,590	\$1,905,506
Deferred revenue, current and noncurrent	2,324,615	2,352,904	2,223,977	3,321,449
Operating cash flow (1)	482,128	239,078	123,732	336,506
Unbilled deferred revenue	4.8 bn	5.0 bn	5.4 bn	5.7 bn

Operating cash flow represents net cash provided by operating activities for the three months ended in the periods stated above. In the first quarter of fiscal year 2017, we adopted Accounting Standards Update No. 2016-09, "Stock

(1) Compensation (Topic 718): Improvements to Employee Shared-Based Payment Accounting" ("ASU 2016-09"), which addresses among other items, updates to the presentation and treatment of excess tax benefits related to stock based compensation on the Statements of Cash Flows. We have adopted changes to the statement of cash flows on a retrospective basis and have accordingly updated the operating cash flow amounts presented above.

(2)

Unbilled deferred revenue represents future billings under our non-cancelable subscription agreements that have not been invoiced and, accordingly, are not recorded in deferred revenue. As of October 31, 2016 and July 31, 2016, approximately \$350.0 million and \$300.0 million, respectively, of the balances presented relates to Demandware, Inc.

## Table of Contents

### Unbilled Deferred Revenue, an Operational Measure

The deferred revenue balance on our consolidated balance sheets does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Unbilled deferred revenue is an operational measure that represents future billings under our subscription agreements that have not been invoiced and, accordingly, are not recorded in deferred revenue. Unbilled deferred revenue amounts by quarter are reflected in the table above. Our typical contract length is between 12 and 36 months. We expect that the amount of unbilled deferred revenue will change from quarter to quarter for several reasons, including the specific timing, duration and size of large customer subscription agreements, varying billing cycles of subscription agreements, the specific timing of customer renewals, foreign currency fluctuations, the timing of when unbilled deferred revenue is to be recognized as revenue, and changes in customer financial circumstances. For multi-year subscription agreements billed annually, the associated unbilled deferred revenue is typically high at the beginning of the contract period, zero just prior to renewal, and increases if the agreement is renewed. Low unbilled deferred revenue attributable to a particular subscription agreement is often associated with an impending renewal and may not be an indicator of the likelihood of renewal or future revenue from such customer. Accordingly, we expect that the amount of aggregate unbilled deferred revenue will change from year-to-year depending in part upon the number and dollar amount of subscription agreements at particular stages in their renewal cycle. Such fluctuations are not a reliable indicator of future revenues. Unbilled deferred revenue does not include minimum revenue commitments from indirect sales channels, as we recognize revenue, deferred revenue, and any unbilled deferred revenue upon sell-through to an end user customer.

### Cost of Revenues and Operating Expenses

**Cost of Revenues.** Cost of subscription and support revenues primarily consists of expenses related to delivering our service and providing support, the costs of data center capacity, depreciation or operating lease expense associated with computer equipment and software, allocated overhead, amortization expense associated with capitalized software related to our services and acquired developed technologies and certain fees paid to various third parties for the use of their technology, services and data. We allocate overhead such as information technology infrastructure, rent and occupancy charges based on headcount. Employee benefit costs and taxes are allocated based upon a percentage of total compensation expense. As such, general overhead expenses are reflected in each cost of revenue and operating expense category. Cost of professional services and other revenues consists primarily of employee-related costs associated with these services, including stock-based expenses, the cost of subcontractors, certain third party fees and allocated overhead. The cost of providing professional services is significantly higher as a percentage of the related revenue than for our enterprise cloud computing subscription service due to the direct labor costs and costs of subcontractors.

We intend to continue to invest additional resources in our enterprise cloud computing services. For example, we have invested in additional database software and we plan to increase the capacity that we are able to offer globally through data centers and third party infrastructure providers. As we acquire new businesses and technologies, the amortization expense associated with this activity will be included in cost of revenues. Additionally, as we enter into new contracts with third parties for the use of their technology, services or data, or as our sales volume grows, the fees paid to use such technology or services may increase. The timing of these additional expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues, in the affected periods.

**Research and Development.** Research and development expenses consist primarily of salaries and related expenses, including stock-based expenses, the costs of our development and test data center and allocated overhead. We continue to focus our research and development efforts on adding new features and services, integrating acquired technologies, increasing the functionality and security and enhancing the ease of use of our enterprise cloud computing services. Our proprietary, scalable and secure multi-tenant architecture enables us to provide all of our customers with a service based on a single version of our application. As a result, we do not have to maintain multiple versions, which enables us to have relatively lower research and development expenses as compared to traditional enterprise software companies.

We expect that in the future, research and development expenses will increase in absolute dollars and may increase as a percentage of total revenues as we invest in building the necessary employee and system infrastructure required to

support the development of new, and improve existing, technologies and the integration of acquired businesses and technologies.

Marketing and Sales. Marketing and sales expenses are our largest cost and consist primarily of salaries and related expenses, including stock-based expenses, for our sales and marketing staff, including commissions, payments to partners, marketing programs and allocated overhead. Marketing programs consist of advertising, events, corporate communications, brand building and product marketing activities.

## Table of Contents

We plan to continue to invest in marketing and sales by expanding our domestic and international selling and marketing activities, building brand awareness, attracting new customers and sponsoring additional marketing events. The timing of these marketing events, such as our annual and largest event, Dreamforce, will affect our marketing costs in a particular quarter. We expect that in the future, marketing and sales expenses will increase in absolute dollars and continue to be our largest cost.

**General and Administrative.** General and administrative expenses consist of salaries and related expenses, including stock-based expenses, for finance and accounting, legal, internal audit, human resources and management information systems personnel, legal costs, professional fees, other corporate expenses and allocated overhead. We expect that in the future, general and administrative expenses will increase in absolute dollars as we invest in our infrastructure and we incur additional employee related costs, professional fees and insurance costs related to the growth of our business and international expansion. We expect general and administrative costs as a percentage of total revenues to either remain flat or decrease for the next several quarters. However, the timing of additional expenses in a particular quarter, both in terms of absolute dollars and as a percentage of revenues, will affect our general and administrative expenses.

**Stock-Based Expenses.** Our cost of revenues and operating expenses include stock-based expenses related to equity plans for employees and non-employee directors. We recognize our stock-based compensation as an expense in the statement of operations based on their fair values and vesting periods. These charges have been significant in the past and we expect that they will increase as our stock price increases, as we acquire more companies, as we hire more employees and seek to retain existing employees.

During the nine months ended October 31, 2016, we recognized stock-based expense of \$576.0 million. As of October 31, 2016, the aggregate stock compensation remaining to be amortized to costs and expenses was approximately \$1.9 billion. We expect this stock compensation balance to be amortized as follows: \$204.4 million during the remaining three months of fiscal 2017; \$690.4 million during fiscal 2018; \$527.4 million during fiscal 2019; \$318.1 million during fiscal 2020; \$78.4 million during fiscal 2021 and \$36.4 million thereafter. The expected amortization reflects only outstanding stock awards as of October 31, 2016 and assumes no forfeiture activity. We expect to continue to issue stock-based awards to our employees in future periods.

**Amortization of Purchased Intangibles from Business Combinations and the Purchase of 50 Fremont.** Our cost of revenues, operating expenses and other expense include amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company's research and development efforts, trade names, customer lists, acquired leases and customer relationships. We expect this expense to increase as we acquire more businesses.

### Critical Accounting Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, which are described in the Notes to the accompanying consolidated financial statements, the following accounting estimates involve a greater degree of judgment and complexity. Accordingly, these are the estimates we believe are the most critical to aid in fully understanding and evaluating our consolidated financial condition and results of operations.

**Revenue Recognition.** We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) related professional services such as process mapping, project management, implementation services and other revenue.

“Other revenue” consists primarily of training fees.

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

- there is persuasive evidence of an arrangement;
- the service has been or is being provided to the customer;

the collection of the fees is reasonably assured; and  
the amount of fees to be paid by the customer is fixed or determinable.

48

---

## Table of Contents

Our subscription service arrangements are non-cancelable and do not contain refund-type provisions.

### Subscription and Support Revenues

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement date of each contract, which is the date our service is made available to customers. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

### Professional Services and Other Revenues

Our professional services contracts are either on a time and material or fixed fee basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized after the services are performed.

### Multiple Deliverable Arrangements

We enter into arrangements with multiple deliverables that generally include multiple subscriptions, premium support, and professional services. If the deliverables have standalone value upon delivery, we account for each deliverable separately. Subscription services have standalone value as such services are often sold separately. In determining whether professional services have standalone value, we consider the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date, and the contractual dependence of the subscription service on the customer's satisfaction with the professional services work. To date, we have concluded that all of the professional services included in multiple deliverable arrangements executed have standalone value.

Multiple deliverables included in an arrangement are separated into different units of accounting and the arrangement consideration is allocated to the identified separate units based on a relative selling price hierarchy. We determine the relative selling price for a deliverable based on its vendor-specific objective evidence of selling price ("VSOE"), if available, or our best estimate of selling price ("BESP"), if VSOE is not available. We have determined that third-party evidence ("TPE") is not a practical alternative due to differences in our service offerings compared to other parties and the availability of relevant third-party pricing information. The amount of revenue allocated to delivered items is limited by contingent revenue, if any.

For certain professional services, we have established VSOE as a consistent number of standalone sales of this deliverable have been priced within a reasonably narrow range. We have not established VSOE for our subscription services due to lack of pricing consistency, the introduction of new services and other factors. Accordingly, we use our BESP to determine the relative selling price of our subscription services.

We determined BESP by considering our overall pricing objectives and market conditions. Significant pricing practices taken into consideration include our discounting practices, the size and volume of our transactions, the customer demographic, the geographic area where our services are sold, our price lists, our go-to-market strategy, historical standalone sales and contract prices. The determination of BESP is made through consultation with and approval by management, taking into consideration the go-to-market strategy. As our go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BESP.

Deferred Revenue. The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription services described above and is recognized as the revenue recognition criteria are met. We generally invoice customers in annual installments. The deferred revenue balance is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing, dollar size and new business linearity within the quarter.

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

Deferred Commissions. We defer commission payments to our direct sales force. The commissions are deferred and amortized to sales expense over the non-cancelable terms of the related subscription contracts with our customers,

which are typically 12 to 36 months. The commission payments, which are paid in full the month after the customer's service commences, are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. We believe this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the same period that the subscription revenue is recognized.



## Table of Contents

During the nine months ended October 31, 2016, we deferred \$227.0 million of commission expenditures and we amortized \$270.5 million to sales expense. During the same period a year ago, we deferred \$200.9 million of commission expenditures and we amortized \$232.8 million to sales expense. Deferred commissions on our consolidated balance sheets totaled \$405.6 million at October 31, 2016 and \$449.1 million at January 31, 2016. Capitalized Internal-Use Software Costs. We are required to follow the guidance of Accounting Standards Codification 350 (“ASC 350”), Intangibles-Goodwill and Other in accounting for the cost of computer software developed for internal-use and the accounting for web-based product development costs. ASC 350 requires companies to capitalize qualifying computer software costs, which are incurred during the application development stage, and amortize these costs on a straight-line basis over the estimated useful life of the respective asset. We deliver our enterprise cloud computing solutions as a service via all the major Internet browsers and on leading major mobile device operating systems. As a result of this software as a service delivery model, we believe we have larger capitalized costs as compared to traditional enterprise software companies as they are required to use a different accounting standard.

Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its estimated useful life. We evaluate the useful lives of these assets on an annual basis and test for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

Business Combinations. Accounting for business combinations requires us to make significant estimates and assumptions, especially at the acquisition date with respect to tangible and intangible assets acquired and liabilities assumed and pre-acquisition contingencies. We use our best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date.

Examples of critical estimates in valuing certain of the intangible assets and goodwill we have acquired include but are not limited to:

- future net expected cash flows from subscription and support contracts, professional services contracts, other customer contracts and acquired developed technologies and patents;
- the acquired company’s trade name, trademark and existing customer relationships, as well as assumptions about the period of time the acquired trade name and trademark will continue to be used in our offerings;
- uncertain tax positions and tax related valuation allowances assumed; and
- discount rates.

Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results.

In the event that we enter into a business combination with an entity in which we previously held a strategic investment, significant gains or losses are disclosed separately within the statements of operations.

Goodwill and Intangibles. We make estimates, assumptions, and judgments when valuing goodwill and other intangible assets in connection with the initial purchase price allocation of an acquired entity, as well as when evaluating the recoverability of our goodwill and other intangible assets on an ongoing basis. These estimates are based upon a number of factors, including historical experience, market conditions, and information obtained from the management of acquired companies. Critical estimates in valuing certain intangible assets include, but are not limited to, historical and projected attrition rates, discount rates, anticipated growth in revenue from the acquired customers and acquired technology, and the expected use of the acquired assets. These factors are also considered in determining the useful life of acquired intangible assets. The amounts and useful lives assigned to identified intangible assets impact the amount and timing of future amortization expense.

Income Taxes. We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statements of operations in the period that includes the enactment date. At each of the interim financial reporting periods, we compute our tax provision by applying an estimated annual effective tax rate to year to date ordinary income or loss and adjust the provision for discrete tax items recorded in the same period. The estimated annual effective tax rate at

each interim period represents our best estimate based on evaluations of possible future transactions and may be subject to subsequent refinement or revision.

50

---

Table of Contents

Valuation allowances are established when necessary to reduce deferred tax assets to the amounts that are more likely than not expected to be realized based on the weighting of positive and negative evidence. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback or carryforward periods available under the applicable tax law. We regularly review the deferred tax assets for recoverability based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. Our judgment regarding future profitability may change due to many factors, including future market conditions and the ability to successfully execute our business plans and tax planning strategies. Should there be a change in the ability to recover deferred tax assets, our income tax provision would increase or decrease in the period in which the assessment is changed.

Our tax positions are subject to income tax audits by multiple tax jurisdictions throughout the world. We recognize the tax benefit of an uncertain tax position only if it is more likely than not that the position is sustainable upon examination by the taxing authority, based on the technical merits. The tax benefit recognized is measured as the largest amount of benefit which is greater than 50 percent likely to be realized upon settlement with the taxing authority. We recognize interest accrued and penalties related to unrecognized tax benefits in our income tax provision.

**Strategic Investments.** We hold strategic investments in marketable equity securities and non-marketable debt and equity securities in which we do not have a controlling interest or significant influence, as defined in Accounting Standards Codification 323 (“ASC 323”), Investments - Equity Method and Joint Ventures. Marketable equity securities are measured using quoted prices in their respective active markets and non-marketable debt and equity securities are recorded at cost and presented in the consolidated balance sheet. If, based on the terms of our ownership of these marketable and non-marketable securities, we determine that we exercise significant influence on the entity to which these marketable and non-marketable securities relate, we apply the requirements of ASC 323 to account for such investments.

We determine the fair value of our marketable equity securities and non-marketable debt and equity securities quarterly for impairment and disclosure purposes; however, the non-marketable debt and equity securities are recorded at fair value only if an impairment is recognized. The measurement of fair value requires significant judgment and includes a qualitative and quantitative analysis of events and circumstances that impact the fair value of the investment. Our assessment of the severity and duration of the impairment and qualitative and quantitative analysis includes the investee’s financial metrics, the investee’s products and technologies meeting or exceeding predefined milestones, market acceptance of the product or technology, other competitive products or technology in the market, general market conditions, management and governance structure of the investee, investee’s liquidity, debt ratios and the rate at which the investee is using its cash, and investee’s receipt of additional funding at a lower valuation. In determining the estimated fair value of our strategic investments in privately held companies, we utilize the most recent data available to us. Valuations of privately held companies are inherently complex due to the lack of readily available market data.

If the fair value of an investment is below our cost, we determine whether the investment is other-than-temporarily impaired based on our qualitative and quantitative analysis, which includes the severity and duration of the impairment. If the investment is considered to be other-than-temporarily impaired, we record the investment at fair value by recognizing an impairment and establishing a new cost basis for the investment.

Table of Contents

## Results of Operations

The following tables set forth selected data for each of the periods indicated (in thousands):

	Three Months Ended		Nine Months Ended	
	October 31, 2016	2015	October 31, 2016	2015
Revenues:				
Subscription and support	\$1,983,981	\$1,596,333	\$5,645,554	\$4,522,939
Professional services and other	160,794	115,634	452,442	334,879
Total revenues	2,144,775	1,711,967	6,097,996	4,857,818
Cost of revenues (1)(2):				
Subscription and support	411,363	303,045	1,108,134	870,023
Professional services and other	174,159	120,638	499,948	340,846
Total cost of revenues	585,522	423,683	1,608,082	1,210,869
Gross profit	1,559,253	1,288,284	4,489,914	3,646,949
Operating expenses (1)(2):				
Research and development	311,459	239,212	863,935	695,440
Marketing and sales	997,993	818,820	2,828,784	2,349,449
General and administrative	246,765	186,818	709,622	544,314
Operating lease termination resulting from purchase of 50 Fremont	0	0	0	(36,617 )
Total operating expenses	1,556,217	1,244,850	4,402,341	3,552,586
Income from operations	3,036	43,434	87,573	94,363
Investment income	3,709	3,507	23,747	11,351
Interest expense	(21,946 )	(18,249 )	(64,665 )	(53,020 )
Other income (expense) (1)	1,782	(7,093 )	(11,500 )	(6,064 )
Gain on sales of land and building improvements	0	21,792	0	21,792
Gains on sales of strategic investments	833	0	13,697	0
Income (loss) before benefit from (provision for) income taxes	(12,586 )	43,391	48,852	68,422
Benefit from (provision for) income taxes (3)	(24,723 )	(68,548 )	182,220	(90,339 )
Net income (loss)	\$(37,309 )	\$(25,157 )	\$231,072	\$(21,917 )

(1) Amounts related to amortization of purchased intangibles from business combinations, as follows (in thousands):

	Three Months		Nine Months	
	Ended October 31, 2016	2015	Ended October 31, 2016	2015
Cost of revenues	\$36,703	\$20,296	\$84,462	\$60,825
Marketing and sales	28,064	18,966	66,601	57,995
Other non-operating expense	579	761	1,927	2,877

(2) Amounts related to stock-based expenses, as follows (in thousands):

	Three Months		Nine Months	
	Ended October 31, 2016	2015	Ended October 31, 2016	2015
Cost of revenues	\$26,783	\$17,516	\$76,912	\$49,237
Research and development	50,372	31,534	124,164	96,508
Marketing and sales	93,718	69,561	275,515	211,819
General and administrative	33,878	25,706	99,389	77,092



Table of Contents

(3) Amounts include a \$205.6 million tax benefit recorded during the nine months ended October 31, 2016 as a result of the partial release of the valuation allowance related to the Demandware, Inc. acquisition. See Note 8 “Income Taxes.”

Revenues by geography were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2016	2015	2016	2015
Americas	\$1,598,344	\$1,258,148	\$4,506,774	\$3,575,441
Europe	337,497	302,704	1,012,671	848,413
Asia Pacific	208,934	151,115	578,551	433,964
	\$2,144,775	\$1,711,967	\$6,097,996	\$4,857,818

Americas revenue attributed to the United States was approximately 96 percent and 95 percent during the three and nine months ended October 31, 2016 and 2015, respectively.

The following tables set forth selected consolidated statements of operations data for each of the periods indicated as a percentage of total revenues:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Revenues:				
Subscription and support	93 %	93 %	93 %	93 %
Professional services and other	7	7	7	7
Total revenues	100	100	100	100
Cost of revenues (1)(2):				
Subscription and support	19	18	18	18
Professional services and other	8	7	8	7
Total cost of revenues	27	25	26	25
Gross profit	73	75	74	75
Operating expenses (1)(2):				
Research and development	15	14	14	14
Marketing and sales	47	48	46	49
General and administrative	11	11	12	11
Operating lease termination resulting from purchase of 50 Fremont	0	0	0	(1 )
Total operating expenses	73	73	72	73
Income from operations	0	2	2	2
Investment income	0	0	0	0
Interest expense	(1 )	(1 )	(1 )	(1 )
Other income (expense) (1)	0	0	0	0
Gain on sales of land and building improvements	0	2	0	1
Gains on sales of strategic investments	0	0	0	0
Income (loss) before benefit from (provision for) income taxes	(1 )	3	1	2
Benefit from (provision for) income taxes	(1 )	(4 )	3	(2 )
Net income (loss)	(2 )%	(1 )%	4 %	0 %

Table of Contents

(1) Amortization of purchased intangibles from business combinations as a percentage of total revenues, as follows:

	Three Months Ended October 31, 2016		Nine Months Ended October 31, 2015	
Cost of revenues	2%	1%	1%	1%
Marketing and sales	1	1	1	1
Other non-operating expense	0	0	0	0

(2) Stock-based expense as a percentage of total revenues, as follows:

	Three Months Ended October 31, 2016		Nine Months Ended October 31, 2015	
Cost of revenues	1%	1%	1%	1%
Research and development	2	2	2	2
Marketing and sales	4	4	5	4
General and administrative	2	1	2	2

Revenues by geography as a percentage of total revenues, as follows:

	Three Months Ended October 31, 2016		Nine Months Ended October 31, 2015	
Americas	74%	73%	74%	74%
Europe	16	18	17	17
Asia Pacific	10	9	9	9
	100%	100%	100%	100%

Revenues and deferred revenue in constant currency, as follows:

	Three Months Ended October 31, 2016	Three Months Ended October 31, 2015
Revenue constant currency growth rates (as compared to the comparable prior periods)	compared to Three Months Ended October 31, 2015	compared to Three Months Ended October 31, 2014
Americas	27%	27%
Europe	27%	28%
Asia Pacific	29%	25%
Total growth	27%	27%

We present constant currency information to provide a framework for assessing how our underlying business performed excluding the effect of foreign currency rate fluctuations. To present this information, current and comparative prior period results for entities reporting in currencies other than United States dollars are converted into United States dollars at the weighted average exchange rate for the quarter being compared to for growth rate calculations presented, rather than the actual exchange rates in effect during that period.

	October 31, 2016 compared to October 31, 2015	January 31, 2016 compared to January 31, 2015
Deferred revenue, current and noncurrent constant currency growth rates (as compared to the comparable prior periods)		
Total growth	25%	31%

To present the information above, we convert the deferred revenue balances in local currencies in previous comparable periods using the United States dollar currency exchange rate as of the most recent balance sheet date.



Table of Contents

Three Months Ended October 31, 2016 and 2015

Revenues.

(in thousands)	Three Months Ended October 31,		Variance	
	2016	2015	Dollars	Percent
Subscription and support	\$1,983,981	\$1,596,333	\$387,648	24%
Professional services and other	160,794	115,634	45,160	39%
Total revenues	\$2,144,775	\$1,711,967	\$432,808	25%

Total revenues were \$2.1 billion for the three months ended October 31, 2016, compared to \$1.7 billion during the same period a year ago, an increase of \$0.4 billion, or 25 percent. Subscription and support revenues were \$2.0 billion, or 93 percent of total revenues, for the three months ended October 31, 2016, compared to \$1.6 billion, or 93 percent of total revenues, during the same period a year ago, an increase of \$0.4 billion, or 24 percent. The increase in subscription and support revenues was primarily caused by volume-driven increases from new business, which includes new customers, upgrades and additional subscriptions from existing customers. Revenue resulting from our July 2016 acquisition of Demandware contributed \$42.2 million to total revenues for the three months ended October 31, 2016. We continue to invest in a variety of customer programs and initiatives, which, along with increasing enterprise adoption, have helped keep our attrition rate consistent as compared to the prior year. Our attrition rate also played a role in the increase in subscription and support revenues. Changes in the net price per user per month have not been a significant driver of revenue growth for the periods presented. Professional services and other revenues were \$160.8 million, or seven percent of total revenues, for the three months ended October 31, 2016, compared to \$115.6 million, or seven percent of total revenues, for the same period a year ago, an increase of \$45.2 million or 39 percent. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers. Revenues from other acquired businesses in fiscal 2017 were not material. Revenues in Europe and Asia Pacific accounted for \$546.4 million, or 26 percent of total revenues, for the three months ended October 31, 2016, compared to \$453.8 million, or 27 percent of total revenues, during the same period a year ago, an increase of \$92.6 million, or 20 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our services, our focus on marketing our services internationally and additional resources. Revenues outside of the Americas increased on a total dollar basis in the three months ended October 31, 2016 despite an overall strengthening of the U.S. dollar. This resulted in a reduction in aggregate international revenues by \$31.9 million compared to the same period a year ago.

Cost of Revenues.

(in thousands)	Three Months Ended October 31,		Variance	
	2016	2015	Dollars	
Subscription and support	\$411,363	\$303,045	\$108,318	
Professional services and other	174,159	120,638	53,521	
Total cost of revenues	\$585,522	\$423,683	\$161,839	
Percent of total revenues	27	% 25	%	

Cost of revenues was \$585.5 million, or 27 percent of total revenues, for the three months ended October 31, 2016, compared to \$423.7 million, or 25 percent of total revenues, during the same period a year ago, an increase of \$161.8 million. The increase in absolute dollars was primarily due to an increase of \$63.5 million in employee-related costs, an increase of \$9.3 million in stock-based expenses, an increase of \$51.2 million in service delivery costs, primarily due to our efforts to increase data center capacity, an increase of \$4.1 million in professional and outside services and third party expenses, an increase of amortization of purchased intangible assets of \$16.4 million and an increase of \$9.8 million in allocated overhead. We have increased our headcount by 36 percent since October 31, 2015 to meet the higher demand for services from our customers. We intend to continue to invest additional resources in our enterprise cloud computing services and data center capacity. We also plan to add additional employees in our professional services group to facilitate the adoption of our services. The timing of these expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.



Table of Contents

The cost of professional services and other revenues was higher than the related revenue during the three months ended October 31, 2016 by \$13.4 million as compared to \$5.0 million during the same period a year ago. We expect the cost of professional services to continue to be more than revenue from professional services in future fiscal quarters. We believe that this investment in professional services facilitates the adoption of our service offerings.

**Research and Development.**

	Three Months Ended		Variance
	October 31,		
(in thousands)	2016	2015	Dollars
Research and development	\$311,459	\$239,212	\$72,247
Percent of total revenues	15	% 14	%

Research and development expenses were \$311.5 million, or 15 percent of total revenues, for the three months ended October 31, 2016, compared to \$239.2 million, or 14 percent of total revenues, during the same period a year ago, an increase of \$72.2 million. The increase in absolute dollars was primarily due to an increase of approximately \$47.7 million in employee-related costs, an increase of \$18.8 million in stock-based expenses, an increase in our development and test data center costs and allocated overhead. We increased our research and development headcount by 34 percent since October 31, 2015 in order to improve and extend our service offerings and develop new technologies. We expect that research and development expenses will increase in absolute dollars and may increase as a percentage of revenues in future periods as we continue to invest in additional employees and technology to support the development of new, and improve existing, technologies and the integration of acquired technologies.

**Marketing and Sales.**

	Three Months Ended		Variance
	October 31,		
(in thousands)	2016	2015	Dollars
Marketing and sales	\$997,993	\$818,820	\$179,173
Percent of total revenues	47	% 48	%

Marketing and sales expenses were \$998.0 million, or 47 percent of total revenues, for the three months ended October 31, 2016, compared to \$818.8 million, or 48 percent of total revenues, during the same period a year ago, an increase of \$179.2 million. The change was primarily due to an increase of \$123.7 million in employee-related costs and amortization of deferred commissions, an increase of \$24.2 million in stock-based expenses, an increase of \$9.1 million related to the amortization of purchased intangible assets, an increase of \$6.6 million in advertising and event expense and an increase of \$8.2 million in allocated overhead. Our marketing and sales headcount increased by 24 percent since October 31, 2015. The increase in headcount was also attributable to hiring additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base.

**General and Administrative.**

	Three Months Ended		Variance
	October 31,		
(in thousands)	2016	2015	Dollars
General and administrative	\$246,765	\$186,818	\$59,947
Percent of total revenues	11	% 11	%

General and administrative expenses were \$246.8 million, or 11 percent of total revenues, for the three months ended October 31, 2016, compared to \$186.8 million, or 11 percent of total revenues, during the same period a year ago, an increase of \$59.9 million. The increase was primarily due to an increase of \$55.4 million in employee-related costs and an increase of \$8.2 million in stock-based expenses. This was offset by a decrease of \$19.7 million in allocated overhead. Our general and administrative headcount increased by 22 percent since October 31, 2015, attributable to hiring additional personnel added to support our growth.



Table of Contents

## Income from operations.

	Three Months Ended		Variance
	October 31,		
(in thousands)	2016	2015	Dollars
Income from operations	\$3,036	\$43,434	\$(40,398)
Percent of total revenues	0	% 2	%

Income from operations for the three months ended October 31, 2016 was \$3.0 million and included \$204.8 million of stock-based expenses and \$64.8 million of amortization of purchased intangibles. During the same period a year ago, income from operations was \$43.4 million and included \$144.3 million of stock-based expenses and \$39.3 million of amortization of purchased intangibles.

## Investment income.

	Three Months		Variance
	Ended October		
(in thousands)	2016	2015	Dollars
Investment income	\$3,709	\$3,507	\$ 202

Investment income consists of income on our cash and marketable securities balances. Investment income was \$3.7 million for the three months ended October 31, 2016 and was \$3.5 million during the same period a year ago.

## Interest expense.

	Three Months Ended		Variance	
	October 31,			
(in thousands)	2016	2015	Dollars	
Interest expense	\$(21,946)	\$(18,249)	\$(3,697)	
Percent of total revenues	(1	)%	(1	)%

Interest expense consists of interest on our convertible senior notes, capital leases, financing obligation related to 350 Mission, the loan assumed on 50 Fremont and the \$500.0 million term loan that was entered into in connection with our acquisition of Demandware. Interest expense was \$21.9 million for the three months ended October 31, 2016 and was \$18.2 million during the same period a year ago.

## Other income (expense).

	Three Months		Variance
	Ended October		
(in thousands)	2016	2015	Dollars
Other income (expense)	\$1,782	\$(7,093)	\$ 8,875

Other income (expense) primarily consists of non-operating transactions such as strategic investments fair market value adjustments, gains and losses from foreign exchange rate fluctuations and real estate transactions. During the three months ended October 31, 2016, we sold shares of one of our now publicly traded strategic investments for a gain of approximately \$9.0 million.

## Gain on sales of land and building improvements.

	Three Months		Variance
	Ended October		
(in thousands)	2016	2015	Dollars
Gain on sales of land and building improvements	\$0	\$21,792	\$(21,792)
Percent of total revenues	0	% 2	%

Gain on sales of land and building improvements consists of the gain we recognized from sales of undeveloped real estate and a portion of associated perpetual parking rights in San Francisco, California. Gain on sales of land and building improvements, net of closing costs, was \$21.8 million during the three months ended October 31, 2015.



Table of Contents

Gains on sales of strategic investments.

	Three Months Ended October 31, 2016	2015	Dollars
Gains on sales of strategic investments	\$833	\$ 0	\$ 833

The gain on the sale of our strategic investments was \$0.8 million for the three months ended October 31, 2016. The gain resulted from our acquisition of Quip in which we previously held an equity interest.

Benefit from (provision for) income taxes.

	Three Months Ended October 31, 2016	2015	Dollars
Benefit from (provision for) income taxes	\$(24,723)	\$(68,548)	\$43,825
Effective tax rate	(196	)% 158	%

We recognized a tax provision of \$24.7 million on a pretax loss of \$12.6 million, which resulted in a negative effective tax rate of 196 percent for the three months ended October 31, 2016. During the current quarter, we finalized the fair value assessment of the assets acquired and liabilities assumed from Demandware, including the customer relationship asset and the customer contract asset. As a result of the updated valuation, we adjusted the net deferred tax liability recognized which correspondingly impacted our valuation allowance because the net deferred tax liability provided a source of additional income to support the realizability of our preexisting deferred tax assets. These changes to the valuation of the acquired assets resulted in a quarterly discrete tax expense of \$60.0 million. Excluding this discrete item, we had a tax benefit of \$35.3 million for the current quarter. The tax benefit was related to our recent acquisitions which changed our quarterly earnings and the recognition of our interim tax provision, resulting in a favorable adjustment to our quarterly income tax provision. Additionally, as a result of early adopting ASU 2016-09 and our valuation allowance position, we did not record any U.S. current income tax expense.

We regularly assess the realizability of our deferred tax assets and establish a valuation allowance if it is more-likely-than-not that some or all of our deferred tax assets will not be realized. We evaluate and weigh all available positive and negative evidence such as historic results, future reversals of existing deferred tax liabilities, projected future taxable income, as well as prudent and feasible tax-planning strategies. Generally, more weight is given to objectively verifiable evidence, such as the cumulative loss in recent years. We will adjust our valuation allowance in the event sufficient positive evidence overcomes the negative evidence of losses in recent years, for example, if our trend in increasing taxable income continues. Due to our valuation allowance, the effective tax rate could be volatile and is therefore difficult to forecast in future periods.

We recorded a tax provision of \$68.5 million with a pretax income of \$43.4 million, which resulted in an effective tax rate of 158 percent for the three months ended October 31, 2015. The tax provision recorded was primarily due to income taxes in profitable jurisdictions outside the United States and the current tax expense in the United States. We had U.S. current tax expense as a result of forecasted taxable income before considering certain excess tax benefits from stock options and vesting of restricted stock.

In addition, the U.S. Tax Court ("Tax Court") issued an opinion favorable to Altera Corporation ("Altera") with respect to Altera's litigation with the Internal Revenue Service ("IRS") related to the treatment of stock-based compensation expense in an inter-company cost-sharing arrangement with Altera's foreign subsidiaries. As a result of this opinion, during the three months ended October 31, 2015, we amended our inter-company cost-sharing arrangement to exclude stock-based compensation expense beginning in fiscal 2016 and accordingly, we recognized the related tax impact through our quarterly tax provision.





Table of Contents

Nine Months Ended October 31, 2016 and 2015

Revenues.

(in thousands)	Nine Months Ended October 31,		Variance	
	2016	2015	Dollars	Percent
Subscription and support	\$5,645,554	\$4,522,939	\$1,122,615	25%
Professional services and other	452,442	334,879	117,563	35%
Total revenues	\$6,097,996	\$4,857,818	\$1,240,178	26%

Total revenues were \$6.1 billion for the nine months ended October 31, 2016, compared to \$4.9 billion during the same period a year ago, an increase of \$1.2 billion, or 26 percent. Subscription and support revenues were \$5.6 billion, or 93 percent of total revenues, for the nine months ended October 31, 2016, compared to \$4.5 billion, or 93 percent of total revenues, during the same period a year ago, an increase of \$1.1 billion, or 25 percent. The increase in subscription and support revenues was primarily caused by volume-driven increases from new business, which includes new customers, upgrades and additional subscriptions from existing customers. Further, subscription revenues benefited due to an additional day in the nine months ended October 31, 2016 compared to the nine months ended October 31, 2015. Our acquisition of Demandware in July 2016 also contributed \$57.9 million. We continue to invest in a variety of customer programs and initiatives, which, along with increasing enterprise adoption, have helped keep our attrition rate consistent as compared to the prior year. Our attrition rate also played a role in the increase in subscription and support revenues. Changes in the net price per user per month have not been a significant driver of revenue growth for the periods presented. Professional services and other revenues were \$452.4 million, or seven percent of total revenues, for the nine months ended October 31, 2016, compared to \$334.9 million, or seven percent of total revenues, for the same period a year ago, an increase of \$117.6 million, or 35 percent. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers. Revenues from other acquired businesses in fiscal 2017 were not material.

Revenues in Europe and Asia Pacific accounted for \$1.6 billion, or 26 percent of total revenues, for the nine months ended October 31, 2016, compared to \$1.3 billion, or 26 percent of total revenues, during the same period a year ago, an increase of \$308.8 million, or 24 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our services, our focus on marketing our services internationally and additional resources. Revenues outside of the Americas increased on a total dollar basis in the nine months ended October 31, 2016 despite an overall strengthening of the U.S. dollar. This resulted in a reduction in aggregate international revenues by \$74.3 million compared to the same period a year ago.

Cost of Revenues.

(in thousands)	Nine Months Ended October 31,		Variance
	2016	2015	Dollars
Subscription and support	\$1,108,134	\$870,023	\$238,111
Professional services and other	499,948	340,846	159,102
Total cost of revenues	\$1,608,082	\$1,210,869	\$397,213
Percent of total revenues	26	% 25	%

Cost of revenues was \$1.6 billion, or 26 percent of total revenues, for the nine months ended October 31, 2016, compared to \$1.2 billion, or 25 percent of total revenues, during the same period a year ago, an increase of \$397.2 million. The increase in absolute dollars was primarily due to an increase of \$177.7 million in employee-related costs, an increase of \$27.7 million in stock-based expenses, an increase of \$109.6 million in service delivery costs, primarily due to our efforts to increase data center capacity, an increase of \$18.3 million in professional and outside services and third party expenses, an increase of amortization of purchased intangible assets of \$23.6 million and an increase of \$21.5 million in allocated overhead. We have increased our headcount by 36 percent since October 31, 2015 to meet the higher demand for services from our customers, of which a component is due to the acquisition of Demandware on July 11, 2016. We intend to continue to invest additional resources in our enterprise cloud computing services and data center capacity. We also plan to add additional employees in our professional services group to facilitate the

adoption of our services. The timing of these expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.

Table of Contents

The cost of professional services and other revenues was higher than the related revenue during the nine months ended October 31, 2016 by \$47.5 million as compared to \$6.0 million during the same period a year ago. We expect the cost of professional services to continue to be more than revenue from professional services in future fiscal quarters. We believe that this investment in professional services facilitates the adoption of our service offerings.

## Research and Development.

	Nine Months Ended		Variance
	October 31,		
(in thousands)	2016	2015	Dollars
Research and development	\$863,935	\$695,440	\$168,495
Percent of total revenues	14	% 14	%

Research and development expenses were \$863.9 million, or 14 percent of total revenues, for the nine months ended October 31, 2016, compared to \$695.4 million, or 14 percent of total revenues, during the same period a year ago, an increase of \$168.5 million. The increase in absolute dollars was primarily due to an increase of approximately \$122.0 million in employee-related costs, an increase of \$27.7 million in stock-based expenses, an increase in our development and test data center costs and allocated overhead. We increased our research and development headcount by 34 percent since October 31, 2015 in order to improve and extend our service offerings and develop new technologies, a component of which is due to the acquisition of Demandware on July 11, 2016. We expect that research and development expenses will increase in absolute dollars and may increase as a percentage of revenues in future periods as we continue to invest in additional employees and technology to support the development of new, and improve existing, technologies and the integration of acquired technologies.

## Marketing and Sales.

	Nine Months Ended October		Variance
	31,		
(in thousands)	2016	2015	Dollars
Marketing and sales	\$2,828,784	\$2,349,449	\$479,335
Percent of total revenues	46	% 49	%

Marketing and sales expenses were \$2.8 billion, or 46 percent of total revenues, for the nine months ended October 31, 2016, compared to \$2.3 billion, or 49 percent of total revenues, during the same period a year ago, an increase of \$479.3 million. The change was primarily due to an increase of \$356.4 million in employee-related costs and amortization of deferred commissions, an increase of \$63.7 million in stock-based expenses, an increase of \$23.7 million in advertising expenses and allocated overhead. Our marketing and sales headcount increased by 24 percent since October 31, 2015. The increase in headcount was primarily attributable to hiring additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base; a component was also due to the acquisition of Demandware on July 11, 2016.

## General and Administrative.

	Nine Months Ended		Variance
	October 31,		
(in thousands)	2016	2015	Dollars
General and administrative	\$709,622	\$544,314	\$165,308
Percent of total revenues	12	% 11	%

General and administrative expenses were \$709.6 million, or 12 percent of total revenues, for the nine months ended October 31, 2016, compared to \$544.3 million, or 11 percent of total revenues, during the same period a year ago, an increase of \$165.3 million. The increase was primarily due to an increase of \$124.3 million in employee-related costs and an increase of \$22.3 million in stock-based expenses. Additionally we incurred \$15.5 million in acquisition costs associated with our acquisition of Demandware on July 11, 2016. Our general and administrative headcount increased by 22 percent since October 31, 2015, a component of which is due to the acquisition of Demandware on July 11, 2016, with additional personnel added to support our growth.



Table of Contents

Operating lease termination resulting from purchase of 50 Fremont.

	Nine Months Ended October 31,		Variance
(in thousands)	2016	2015	Dollars
Operating lease termination resulting from purchase of 50 Fremont	\$0	\$(36,617)	\$36,617
Percent of total revenues	0 %	(1 )%	

Operating lease termination resulting from purchase of 50 Fremont for the nine months ended October 31, 2015 was \$36.6 million. In connection with the February 2015 purchase, we recognized a net non-cash gain totaling approximately \$36.6 million on the termination of our office lease signed in January 2012.

Income from operations.

	Nine Months Ended October 31,		Variance
(in thousands)	2016	2015	Dollars
Income from operations	\$87,573	\$94,363	\$(6,790)
Percent of total revenues	2 %	2 %	

Income from operations for the nine months ended October 31, 2016 was \$87.6 million and included \$576.0 million of stock-based expenses, \$15.5 million of transaction costs associated with our acquisition of Demandware and \$151.1 million of amortization of purchased intangibles. During the same period a year ago, income from operations was \$94.4 million and included a gain of \$36.6 million related to the purchase of 50 Fremont, \$434.7 million of stock-based expenses and \$118.8 million of amortization of purchased intangibles.

Investment income.

	Nine Months Ended October 31,		Variance
(in thousands)	2016	2015	Dollars
Investment income	\$23,747	\$11,351	\$12,396

Investment income consists of income on our cash and marketable securities balances. Investment income was \$23.7 million for the nine months ended October 31, 2016 and was \$11.4 million during the same period a year ago. The increase was due to both realized gains resulting from the sales of marketable securities as well as higher interest income across our portfolio.

Interest expense.

	Nine Months Ended October 31,		Variance
(in thousands)	2016	2015	Dollars
Interest expense	\$(64,665)	\$(53,020)	\$(11,645)
Percent of total revenues	(1 )%	(1 )%	

Interest expense consists of interest on our convertible senior notes, capital leases, term loan, financing obligation related to 350 Mission, the loan assumed on 50 Fremont and the \$500.0 million term loan that was entered into in connection with our acquisition of Demandware. Interest expense was \$64.7 million for the nine months ended October 31, 2016 and was \$53.0 million during the same period a year ago.

Other expense.

	Nine Months Ended October 31,		Variance
(in thousands)	2016	2015	Dollars
Other expense	\$(11,500)	\$(6,064)	\$(5,436)



Table of Contents

Other expense primarily consists of non-operating costs such as strategic investments fair market value adjustments, gains and losses from foreign exchange rate fluctuations and real estate transactions.

Gain on sales of strategic investments.

	Nine Months Ended			Variance
	October 31,			
(in thousands)	2016	2015	Dollars	
Gains on sales of strategic investments	\$13,697	\$ 0	\$13,697	

Gains on sales of strategic investments were \$13.7 million for the nine months ended October 31, 2016. Gains on sales of strategic investments primarily consist of gains on sales of strategic investments resulting from mergers and acquisitions that we initiated in which we previously held an equity interest.

Benefit from (provision for) income taxes.

	Nine Months Ended		Variance
	October 31,		
(in thousands)	2016	2015	Dollars
Benefit from (provision for) income taxes	\$182,220	\$(90,339)	\$272,559
Effective tax rate	(373	)%	132 %

We recognized a tax benefit of \$182.2 million on a pretax income of \$48.9 million, which resulted in a negative effective tax rate of 373 percent for the nine months ended October 31, 2016. The most significant component of this tax amount was the discrete tax benefit of \$205.6 million from a partial release of the valuation allowance in connection with the acquisition of Demandware. The net deferred tax liability from the acquisition of Demandware provided a source of additional income to support the realizability of our preexisting deferred tax assets and as a result, we released a portion of our tax valuation allowance. The tax benefit associated with the release of the valuation allowance was partially offset by income taxes in profitable jurisdictions outside of the United States. Additionally, as a result of early adopting ASU 2016-09 and our valuation allowance position, we did not record any U.S. current income tax expense.

We regularly assess the realizability of our deferred tax assets and establish a valuation allowance if it is more-likely-than-not that some or all of our deferred tax assets will not be realized. We evaluate and weigh all available positive and negative evidence such as historic results, future reversals of existing deferred tax liabilities, projected future taxable income, as well as prudent and feasible tax-planning strategies. Generally, more weight is given to objectively verifiable evidence, such as the cumulative loss in recent years. We will adjust our valuation allowance in the event sufficient positive evidence overcomes the negative evidence of losses in recent years, for example, if our trend in increasing taxable income continues. Due to our valuation allowance, the effective tax rate could be volatile and is therefore difficult to forecast in future periods.

We recorded a tax provision of \$90.3 million with a pretax income of \$68.4 million, which resulted in an effective tax rate of 132 percent for the nine months ended October 31, 2015. We had a tax provision primarily due to income taxes in profitable jurisdictions outside the United States and the current tax expense in the United States. We had U.S. current tax expense as a result of forecasted taxable income before considering certain excess tax benefits from stock options and vesting of restricted stock.

In addition, the Tax Court issued an opinion favorable to Altera with respect to Altera's litigation with the IRS related to the treatment of stock-based compensation expense in an inter-company cost-sharing arrangement with Altera's foreign subsidiaries. As a result of this opinion, during the nine months ended October 31, 2015, we amended our inter-company cost-sharing arrangement to exclude stock-based compensation expense beginning in fiscal 2016 and accordingly, we recognized the related tax impact through our year-to-date tax provision.

#### Liquidity and Capital Resources

At October 31, 2016, our principal sources of liquidity were cash, cash equivalents and marketable securities totaling \$1.8 billion and accounts receivable of \$1.3 billion.

Net cash provided by operating activities was \$1.5 billion during the nine months ended October 31, 2016 and \$1.2 billion during the same period a year ago. Cash provided by operating activities has historically been affected by the

amount of net income adjusted for non-cash expense items such as depreciation and amortization; amortization of purchased intangibles from business combinations; amortization of debt discount; discrete items such as the non-cash gain from the termination of the 50 Fremont lease; the expense associated with stock-based awards; gains on sales of strategic investments; the timing of

62

---



Table of Contents

employee related costs including commissions and bonus payments; the timing of payments against accounts payable, accrued expenses and other current liabilities; the timing of collections from our customers, which is our largest source of operating cash flows; the timing of business combination activity and the related integration and transaction costs; and changes in working capital accounts. Net cash provided by operating activities was also impacted by payments made during the nine months ended October 31, 2016 for the transaction fees related to the acquisition of Demandware.

Our working capital accounts consist of accounts receivable, deferred commissions, prepaid assets and other current assets. Claims against working capital include accounts payable, accrued expenses, deferred revenue, and other current liabilities and payments related to our debt obligations. Our working capital may be impacted by factors in future periods such as billings to customers for subscriptions and support services and the subsequent collection of those billings, certain amounts and timing of which are seasonal. Our working capital in some quarters, like the three months ended October 31, 2016, may be impacted by adverse foreign currency exchange rate movements. Our billings are also influenced by new business linearity within the quarters and across quarters.

As described above in “Seasonal Nature of Deferred Revenue, Accounts Receivable and Operating Cash Flow,” our fourth quarter has historically been our strongest quarter for new business and renewals and, correspondingly, the first quarter for cash collections. The year on year compounding effect of this seasonality in both billing patterns and overall business causes both the value of invoices that we generate in the fourth quarter and cash collections in the first quarter to increase as a proportion of our total annual billings.

We generally invoice our customers for our subscription and services contracts in advance in annual installments. We typically issue renewal invoices in advance of the renewal service period, and depending on timing, the initial invoice for the subscription and services contract and the subsequent renewal invoice may occur in different quarters. Such invoice amounts are initially reflected in accounts receivable and deferred revenue, which is reflected on the balance sheets. The operating cash flow benefit of increased billing activity generally occurs in the subsequent quarter when we collect from our customers. As such, our first quarter is our largest collections and operating cash flow quarter. Net cash used in investing activities was \$2.2 billion during the nine months ended October 31, 2016 and \$882.6 million during the same period a year ago. The net cash used in investing activities during the nine months ended October 31, 2016 primarily related to the acquisition of Demandware in July 2016, purchases of marketable securities of approximately \$986.9 million and strategic and capital investments, which were offset by the cash inflows for the period from the sales of marketable securities of \$1.9 billion.

Net cash provided by financing activities was \$737.7 million during the nine months ended October 31, 2016 as compared to net cash used in financing activities of \$1.0 million during the same period a year ago. Net cash provided by financing activities during the nine months ended October 31, 2016 consisted primarily of \$495.6 million of proceeds from the Term Loan, net of loan fees, \$315.9 million from proceeds from equity plans and the reclassification of excess tax benefits from employee stock plans to cash flows from operating activities due to the early adoption of ASU 2016-09 offset by \$73.8 million of principal payments on capital leases.

In March 2013, we issued at par value \$1.15 billion of 0.25% convertible senior notes (the “Notes”), due April 1, 2018, unless earlier purchased by us or converted. The Notes will be convertible if during any 20 trading days during the 30 consecutive trading days of any fiscal quarter, our common stock trades at a price exceeding 130% of the conversion price of \$66.44 per share applicable to the Notes. The Notes are classified as a noncurrent liability on our consolidated balance sheet as of October 31, 2016. Our common stock did not trade at a price exceeding 130% of the conversion price of \$66.44 per share applicable to the Notes during the fiscal quarter ended October 31, 2016. Accordingly, the Notes were not convertible at the holders’ option.

In July 2016, we entered into a credit agreement (the “Revolving Loan Credit Agreement”), which provides for a \$1.0 billion unsecured revolving credit facility (the “Credit Facility”) that matures in July 2021. We may use any future borrowings under the Credit Facility for refinancing other indebtedness, working capital, capital expenditures and other general corporate purposes, including permitted acquisitions. We may borrow amounts under the Credit Facility at any time during the term of the Revolving Loan Credit Agreement. As of October 31, 2016, we had no outstanding borrowings under the Credit Facility. In November 2016, we borrowed \$750.0 million under the Credit Facility, in

part to fund the acquisition of Krux Digital, Inc. See Note 13 “Subsequent Events.”

The Revolving Loan Credit Agreement contains certain customary affirmative and negative covenants, including a consolidated leverage ratio covenant, a consolidated interest coverage ratio covenant, a limit on our ability to incur additional indebtedness, dispose of assets, make certain acquisition transactions, pay dividends or distributions, and certain other

Table of Contents

restrictions on our activities each defined specifically in the Revolving Loan Credit Agreement. We were in compliance with the Revolving Loan Credit Agreement's covenants as of October 31, 2016.

In February 2015, we acquired 50 Fremont Street, a 41-story building totaling approximately 817,000 rentable square feet located in San Francisco, California ("50 Fremont"). At the time of the acquisition, we were leasing approximately 500,000 square feet of the available space in 50 Fremont.

The total purchase price for 50 Fremont was \$637.6 million. In financing the purchase price, we used \$115.0 million of restricted cash on hand and assumed a \$200.0 million loan secured by the property with the remainder paid in cash. In April 2016, we entered into an agreement with a third party provider for certain infrastructure services for a period of four years. The agreement provides that we will pay \$35.0 million in the remainder of fiscal 2017, \$96.0 million in fiscal 2018, \$108.0 million in fiscal 2019 and \$126.0 million in fiscal 2020.

In July 2016, in order to partially finance the acquisition of Demandware, we entered into a \$500.0 million term loan (the "Term Loan") which matures in July 2019 and bears interest at our option, at either a base rate plus a spread of 0.00% to 0.75% or an adjusted LIBOR rate plus a spread of 1.00% to 1.75%. The weighted average interest rate on the Term Loan was 1.8% as of October 31, 2016.

Our cash, cash equivalents and marketable securities are comprised primarily of corporate notes and other obligations, U.S. treasury securities, government obligations, collateralized mortgage obligations, mortgage backed securities, time deposits, money market mutual funds and municipal securities.

As of October 31, 2016, we have a total of \$84.0 million in letters of credit outstanding in favor of certain landlords for office space. To date, no amounts have been drawn against the letters of credit, which renew annually and expire at various dates through December 2030.

We do not have any special purpose entities, and other than operating leases for office space and computer equipment, we do not engage in off-balance sheet financing arrangements.

Our principal commitments consist of obligations under leases for office space, co-location data center facilities and our development and test data center, as well as leases for computer equipment, software, furniture and fixtures. At October 31, 2016, the future non-cancelable minimum payments under these commitments were as follows (in thousands):

	Capital Leases	Operating Leases	Financing Obligation - Leased Facility
Fiscal Period:			
Remaining three months of fiscal 2017	\$26,431	\$109,755	\$5,322
Fiscal 2018	122,649	429,673	21,437
Fiscal 2019	115,791	382,264	21,881
Fiscal 2020	201,576	303,873	22,325
Fiscal 2021	35	264,798	22,770
Thereafter	0	1,445,905	233,927
Total minimum lease payments	466,482	\$2,936,268	\$327,662
Less: amount representing interest	(41,368)		
Present value of capital lease obligations	\$425,114		

The majority of our operating lease agreements provide us with the option to renew. Our future operating lease obligations would change if we exercised these options and if we entered into additional operating lease agreements as we expand our operations.

The financing obligation above represents the total obligation for our lease of approximately 445,000 rentable square feet of office space in San Francisco, California. As of October 31, 2016, \$220.8 million of the total obligation noted above was recorded to Financing obligation - leased facility, of which the current portion is included in "Accounts

payable, accrued expenses and other liabilities” and the non-current portion is included in “Other noncurrent liabilities” on the consolidated balance sheets.

64

---

Table of Contents

In February 2016, the Company entered into an agreement to sublease additional office space in New York, New York. The amounts associated with the agreement will be approximately \$288.0 million over the approximately 12 year term of the agreement, beginning in the Company's first quarter of fiscal 2018. In May 2016, the Company entered into an agreement to lease additional office space in Indianapolis, Indiana. The amounts associated with the agreement will be approximately \$77.0 million over the approximately 13 year term of the agreement, beginning in the Company's second quarter of fiscal 2018.

During the remaining months of fiscal 2017 and in future fiscal years, we have made and expect to continue to make additional investments in our infrastructure to scale our operations and increase productivity. We plan to upgrade or replace various internal systems to scale with the overall growth of the Company. Additionally, we expect capital expenditures to be higher in absolute dollars and remain consistent as a percentage of total revenues in future periods as a result of continued office build-outs, other leasehold improvements and data center investments.

In the future, we may enter into arrangements to acquire or invest in complementary businesses or joint ventures, services and technologies, and intellectual property rights. To facilitate these acquisitions or investments, we may seek additional equity or debt financing, which may not be available on terms favorable to us or at all, which may affect our ability to complete subsequent acquisitions or investments, and which may affect the risks of owning our common stock.

We believe our existing cash, cash equivalents and short-term marketable securities and cash provided by operating activities will be sufficient to meet our working capital, capital expenditure and debt repayment needs over the next 12 months.

**New Accounting Pronouncements**

See Note 1 "Summary of Business and Significant Accounting Policies" to the consolidated financial statements for our discussion about new accounting pronouncements adopted and those pending.

Table of Contents

## Non-GAAP Financial Measures

Regulation S-K Item 10(e), "Use of Non-GAAP Financial Measures in Commission Filings," defines and prescribes the conditions for use of non-GAAP financial information. Our measures of non-GAAP net income, non-GAAP gross profit, non-GAAP operating profit, non-GAAP free cash flow, non-GAAP earnings per share, and constant currency results, each meet the definition of a non-GAAP financial measure. The primary purpose of using non-GAAP measures is to provide supplemental information that may prove useful to investors who wish to consider the impact of certain non-cash or non-recurring items on the Company's operating performance and to enable investors to evaluate the Company's results in the same way management does. These non-cash or non-recurring items generally consist of one-time items resulting from strategic decisions that affect multiple periods or periods unrelated to when the actual items were incurred. Management believes that supplementing GAAP disclosure with non-GAAP disclosure that excludes items that are not directly related to performance in any particular period provides investors with a more complete view of the company's operational performance and allows for meaningful period-to-period comparisons and analysis of trends in the Company's business. Further, to the extent that other companies use similar methods in calculating non-GAAP measures, the provision of supplemental non-GAAP information can allow for a comparison of the Company's relative performance against other companies that also report non-GAAP operating results.

## Non-GAAP net income

We define non-GAAP net income as our total net income excluding the components described below, which we believe are not reflective of our core, ongoing operating results. In each case, for the reasons set forth below, we believe that excluding the component provides useful information to investors and others in understanding and evaluating the impact of certain items to our operating results and future prospects in the same manner as we do, in comparing financial results across accounting periods and to those of peer companies and in better understanding the impact of these items on our gross margin and operating performance.

**Stock-Based Expense.** The Company's compensation strategy includes the use of stock-based compensation to attract and retain employees and executives. It is principally aimed at aligning their interests with those of our stockholders and at long-term employee retention, rather than to motivate or reward operational performance for any particular period. Thus, stock-based expense varies for reasons that are generally unrelated to operational decisions and performance in any particular period.

**Amortization of Purchased Intangibles and Acquired Leases.** The Company views amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company's research and development efforts, trade names, customer lists, customer relationships and acquired lease intangibles, as items arising from pre-acquisition activities determined at the time of an acquisition. While these intangible assets are continually evaluated for impairment, amortization of the cost of purchased intangibles is a static expense, one that is not typically affected by operations during any particular period.

**Amortization of Debt Discount.** Under GAAP, certain convertible debt instruments that may be settled in cash (or other assets) on conversion are required to be separately accounted for as liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. Accordingly, for GAAP purposes we are required to recognize imputed interest expense on the Company's \$1.15 billion of convertible senior notes due 2018 that were issued in a private placement in March 2013. The imputed interest rate was approximately 2.53% for the convertible notes due 2018, while the actual coupon interest rate of the notes was 0.25%. The difference between the imputed interest expense and the coupon interest expense, net of the interest amount capitalized, is excluded from management's assessment of the Company's operating performance because management believes that this non-cash expense is not indicative of its core, ongoing operating performance.

**Gains and Losses on Strategic Investments.** The Company views gains and losses on sales of its strategic investments resulting from acquisitions initiated by the Company in which an equity interest was previously held as discrete events and not indicative of operational performance during any particular period. However, there may be other gains and losses from companies in which the Company previously held an equity interest resulting from acquisitions by a third party during a particular period. These specific gains and losses would not be excluded from the Company's GAAP results to arrive at non-GAAP net income.

Gain on Sales of Land and Building Improvements. The Company views the non-operating gains associated with the sales of the land and building improvements at Mission Bay to be a discrete item. The difference between the cash proceeds received and the carrying value of the land and the building improvements as of the settlement date is recorded as a one-time gain on the statement of operations. Management believes that the exclusion of the gains provides investors an enhanced view of the Company's operational performance.

Table of Contents

**Lease Termination Resulting from Purchase of Office Building.** The Company views the non-cash, one-time gain associated with the termination of its lease at 50 Fremont to be a discrete item.

**Income Tax Effects and Adjustments.** The Company utilizes a fixed long-term projected non-GAAP tax rate in order to provide better consistency across the interim reporting periods by eliminating the effects of non-recurring and period-specific items such as changes in the tax valuation allowance and tax effects of acquisitions-related costs, since each of these can vary in size and frequency. When projecting this long-term rate, the Company evaluated a three-year financial projection that excludes the direct impact of the following non-cash items: stock-based expenses, amortization of purchased intangibles, amortization of acquired leases, amortization of debt discount, gains/losses on conversions of debt, gains on sales of strategic investments and land and building improvements and termination of office leases. The projected rate also assumes no new acquisitions in the three-year period, and considers other factors including the Company's tax structure, its tax positions in various jurisdictions and key legislation in major jurisdictions where the company operates. This long-term rate could be subject to change for a variety of reasons, such as significant changes in the geographic earnings mix including acquisition activity, or fundamental tax law changes in major jurisdictions where the company operates. The Company re-evaluates this long-term rate on an annual basis or if any significant events that may materially affect this long-term rate occur. The non-GAAP tax rate for fiscal 2017 is 35.0 percent. At the start of fiscal 2016, the Company used a tax rate of 36.5 percent, which was revised to 35.5 percent during the quarter ended October 31, 2015 to account for the related tax impact from the Tax Court decision in Altera Corporation's litigation with the Internal Revenue Service.

Additionally, as significant, unusual or discrete events occur, or as other events occur that are not related to the Company's core, ongoing operating results, we may exclude the financial results of these events from non-GAAP net income in the period in which such events occur. For example, the financial effects of significant facilities-related transactions may in the future be excluded from non-GAAP net income in the period in which such events may occur, if they are not viewed by management as reflective of our core, ongoing operating results.

**Non-GAAP gross profit**

We define non-GAAP gross profit as our total revenues less cost of revenues, as reported on our consolidated statement of operations, excluding the portions of stock-based expenses and amortization of purchased intangibles that are included in cost of revenues.

**Non-GAAP operating profit**

We define non-GAAP operating profit as our non-GAAP gross profit less operating expenses, as reported on our consolidated statement of operations, excluding the portions of stock-based expenses, amortization of purchased intangibles and gain resulting from termination of our office lease that are included in operating expenses.

**Non-GAAP earnings per share**

We define non-GAAP earnings per share as our non-GAAP net income divided by basic or diluted shares outstanding.

**Non-GAAP free cash flow**

We define the non-GAAP measure free cash flow as GAAP net cash provided by operating activities, less capital expenditures. For this purpose, capital expenditures does not include our strategic investments, nor does it include any costs or activities related to our purchase of 50 Fremont land and building, and construction costs related to building - leased facilities.

**Constant currency results**

We present constant currency information to provide a framework for assessing how our underlying business performed excluding the effect of foreign currency rate fluctuations. To present this information, current and comparative prior period results for entities reporting in currencies other than United States dollars are converted into United States dollars at the weighted average exchange rate for the quarter being compared to for growth rate calculations presented, rather than the actual exchange rates in effect during that period. To present deferred revenue on a constant currency basis, we convert the deferred revenue balances in local currencies in previous comparable periods using the United States dollar currency exchange rate as of the most recent balance sheet date.

**Limitations on the use of non-GAAP financial measures**

A limitation of our non-GAAP financial measures of non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income, non-GAAP earnings per share, non-GAAP free cash flow, and constant currency results is that they do not



have

67

---

Table of Contents

uniform definitions. Our definitions will likely differ from the definitions used by other companies, including peer companies, and therefore comparability may be limited. These non-GAAP measures should be considered in addition to, not as a substitute for, or in isolation from, measures prepared in accordance with GAAP. Additionally, in the case of stock-based expense, if we did not pay a portion of compensation in the form of stock-based expense, the cash salary expense included in costs of revenues and operating expenses would be higher which would affect our cash position.

We compensate for these limitations by reconciling our non-GAAP financial measures to the most comparable GAAP financial measures. We encourage investors and others to review our financial information in its entirety, not to rely on any single financial measure, and to view our non-GAAP financial measures in conjunction with the most comparable GAAP financial measures.

Our reconciliation of the non-GAAP financial measures to the most comparable GAAP measures for the three and nine months ended October 31, 2016 and 2015 are as follows (in thousands, except for share numbers):

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2016	2015	2016	2015
Non-GAAP gross profit				
GAAP gross profit	\$1,559,253	\$1,288,284	\$4,489,914	\$3,646,949
Plus:				
Amortization of purchased intangibles	36,703	20,296	84,462	60,825
Stock-based expense	26,783	17,516	76,912	49,237
Non-GAAP gross profit	\$1,622,739	\$1,326,096	\$4,651,288	\$3,757,011
			Three Months Ended October 31,	
			2016	2015
			Nine Months Ended October 31,	
			2016	2015
Non-GAAP income from operations				
GAAP income from operations			\$3,036	\$43,434
Plus:				
Amortization of purchased intangibles			64,767	39,262
Stock-based expense			204,751	144,317
Less:				
Operating lease termination resulting from purchase of 50 Fremont			0	0
Non-GAAP income from operations			\$272,554	\$227,013
			\$814,616	\$611,222

Table of Contents

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2016	2015	2016	2015
Non-GAAP net income				
GAAP net income (loss)	\$(37,309 )	\$(25,157 )	\$231,072	\$(21,917 )
Plus:				
Amortization of purchased intangibles	64,767	39,262	151,063	118,820
Amortization of acquired lease intangible	579	761	1,927	2,877
Stock-based expense	204,751	144,317	575,980	434,656
Amortization of debt discount, net	6,304	6,148	18,794	18,317
Less:				
Operating lease termination resulting from purchase of 50 Fremont	0	0	0	(36,617 )
Gain on sales of land and building improvements	0	(21,792 )	0	(21,792 )
Gains on sales of strategic investments	(833 )	0	(13,697 )	0
Income tax effects and adjustments	(67,320 )	(3,016 )	(456,241 )	(117,223 )
Non-GAAP net income	\$170,939	\$140,523	\$508,898	\$377,121

	Three Months		Nine Months	
	Ended October		Ended October	
	31,	31,	31,	31,
	2016	2015	2016	2015
Non-GAAP diluted earnings per share				
GAAP diluted net income per share	\$(0.05)	\$(0.04)	\$0.33	\$(0.03)
Plus:				
Amortization of purchased intangibles	0.09	0.06	0.22	0.18
Amortization of acquired lease intangible	0.00	0.00	0.00	0.00
Stock-based expenses	0.29	0.21	0.83	0.65
Amortization of debt discount, net	0.01	0.01	0.03	0.03
Less:				
Operating lease termination resulting from purchase of 50 Fremont	0.00	0.00	0.00	(0.05 )
Gain on sales of land and building improvements	0.00	(0.03 )	0.00	(0.03 )
Gains on sales of strategic investments	0.00	0.00	(0.02 )	0.00
Income tax effects and adjustments	(0.10 )	0.00	(0.66 )	(0.19 )
Non-GAAP diluted earnings per share	\$0.24	\$0.21	\$0.73	\$0.56

Shares used in computing Non-GAAP diluted net income per share 704,704 677,730 696,257 672,336

Non-GAAP income from operations for the quarter ended October 31, 2016 was \$272.6 million and \$227.0 million for the same period a year ago, an increase of \$45.5 million or 20 percent. During the first nine months of fiscal 2017 we remained focused on improving non-GAAP operating profit and expect to remain similarly focused for the remaining three months of fiscal 2017.

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2016	2015	2016	2015
Free cash flow analysis				
Operating cash flow				
GAAP net cash provided by operating activities	\$154,312	\$162,514	\$1,456,052	\$1,201,873
Less:				
Capital expenditures	(140,653 )	(80,041 )	(319,984 )	(216,011 )
Free cash flow	\$13,659	\$82,473	\$1,136,068	\$985,862



Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Risk

We primarily conduct our business in the following locations: the United States, Europe, Canada, Asia Pacific and Japan. The expanding global scope of our business exposes us to risk of fluctuations in foreign currency markets. This exposure is the result of selling in multiple currencies, growth in our international investments, including data center expansion, additional headcount in foreign countries, and operating in countries where the functional currency is the local currency. Specifically, our results of operations and cash flows are subject to fluctuations in the following currencies: the Euro, British Pound Sterling, Canadian Dollar, Australian Dollar and Japanese Yen against the United States Dollar (“USD”). These exposures may change over time as business practices evolve and economic conditions change. Changes in foreign currency exchange rates could have an adverse impact on our financial results and cash flows. For example, revenue for the third quarter of fiscal 2017 was \$2.1 billion, an increase of 25 percent since the same period a year ago, and 27 percent in constant currency. Deferred revenue on the balance sheet as of October 31, 2016 was \$3.5 billion, an increase of 23 percent year over year, and 25 percent in constant currency.

Our European revenue, operating expenses and significant balance sheet accounts denominated in currencies other than the USD primarily flow through our United Kingdom subsidiary, which has a functional currency of the British Pound. This results in a two-step currency exchange process wherein the currencies in Europe other than the British Pound are first converted into the British Pound and then British Pounds are translated into USD for our Consolidated Financial Statements. As an example, costs incurred in France are translated from the Euro to the British Pound and then into the USD. Our Statement of Operations and balance sheet accounts are also impacted by the re-measurement of non-functional currency transactions such as USD denominated intercompany loans, cash accounts held by our overseas subsidiaries, accounts receivable denominated in foreign currencies, deferred revenue and accounts payable denominated in foreign currencies.

Foreign Currency Transaction Risk

Our foreign currency exposures typically arise from selling annual and multi-year subscriptions in multiple currencies, customer trade account receivables, intercompany transfer pricing arrangements and other intercompany transactions. Our foreign currency management objective is to minimize the effect of fluctuations in foreign exchange rates on selected assets or liabilities without exposing us to additional risk associated with transactions that could be regarded as speculative.

We pursue our objective by utilizing foreign currency forward contracts to offset foreign exchange risk. Our foreign currency forward contracts are generally short-term in duration. We neither use these foreign currency forward contracts for trading purposes nor do we currently designate these forward contracts as hedging instruments pursuant to Accounting Standards Codification 815 (“ASC 815”), Derivatives and Hedging. Accordingly, we record the fair values of these contracts as of the end of our reporting period to our consolidated balance sheet with changes in fair values recorded to our consolidated statement of operations. Given the short duration of the forward contracts, the amount recorded is not significant. Our ultimate realized gain or loss with respect to foreign currency exposures will generally depend on the size and type of cross-currency transactions that we enter into, the currency exchange rates associated with these exposures and changes in those rates, the net realized gain or loss on our foreign currency forward contracts and other factors.

Foreign Currency Translation Risk

Fluctuations in foreign currencies impact the amount of total assets, liabilities, revenues, operating expense and cash flows that we report for our foreign subsidiaries upon the translation of these amounts into U.S. Dollars. As the U.S. Dollar strengthened against certain international currencies over the past several months, the amounts of revenue and deferred revenue that we reported in U.S. Dollars for foreign subsidiaries that transact in international currencies were lower relative to what we would have reported using a constant currency rate. We report in Management's Discussion and Analysis our revenue and deferred revenue growth rates on both an absolute dollar and constant currency basis.

Interest Rate Sensitivity

We had cash, cash equivalents and marketable securities totaling \$1.8 billion at October 31, 2016. This amount was invested primarily in money market funds, time deposits, corporate notes and bonds, government securities and other

debt securities with credit ratings of at least BBB or better. The cash, cash equivalents and short-term marketable securities are held for general corporate purposes including possible acquisitions of, or investments in, complementary businesses, services or technologies, working capital and capital expenditures. Our investments are made for capital preservation purposes. We do not enter into investments for trading or speculative purposes.

Our cash equivalents and our portfolio of marketable securities are subject to market risk due to changes in interest rates. Fixed rate securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities

Table of Contents

may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. However because we classify our debt securities as “available for sale,” no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary. Our fixed-income portfolio is subject to interest rate risk.

An immediate increase or decrease in interest rates of 100-basis points at October 31, 2016 could result in a \$12.9 million market value reduction or increase of the same amount. This estimate is based on a sensitivity model that measures market value changes when changes in interest rates occur. Fluctuations in the value of our investment securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities.

At January 31, 2016, we had cash, cash equivalents and marketable securities totaling \$2.7 billion. The fixed-income portfolio was also subject to interest rate risk. Changes in interest rates of 100-basis points would have resulted in market value changes of \$20.9 million.

**Market Risk and Market Interest Risk**

In March 2013, we issued at par value \$1.15 billion of 0.25% convertible senior notes (the “Notes”) due April 1, 2018. Holders of the Notes may convert the Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, we would pay the holder an amount of cash equal to the principal amounts of the Notes. The amounts in excess of the principal amounts, if any, may be paid in cash or stock at our option. Concurrent with the issuance of the Notes, we entered into separate note hedging transactions and the sale of warrants. These separate transactions were completed to reduce the potential economic dilution from the conversion of the Notes.

The Notes have a fixed annual interest rate of 0.25%, and therefore we do not have economic interest rate exposure on the Notes. However, the value of the Notes are exposed to interest rate risk. Generally, the fair values of our fixed interest rate Notes will increase as interest rates fall and decrease as interest rates rise. In addition, the fair value of our 0.25% Notes is affected by our stock price. The principal balance of our Notes was \$1.15 billion as of October 31, 2016. The total estimated fair value of our Notes at October 31, 2016 was \$1.4 billion. The fair value was determined based on the closing trading price per \$100 of the Notes as of the last day of trading for the third quarter of fiscal 2017, which was \$123.01.

In July 2016, we amended our credit agreement (the “Revolving Loan Credit Agreement”) to provide for a \$1.0 billion unsecured revolving credit facility (the “Credit Facility”) that matures in July 2021.

The Borrowings under the Credit Facility bear interest, at the our option, at a base rate plus a spread of 0.00% to 0.75% or an adjusted LIBOR rate plus a spread of 1.00% to 1.75%, in each case with such spread being determined based on our consolidated leverage ratio for the preceding four fiscal quarter period. Regardless of what amounts, if any, are outstanding under the revolving credit facility, we are also obligated to pay an ongoing commitment fee at a rate of 0.125% to 0.25%, with such rate being based on the our consolidated leverage ratio for the preceding four fiscal quarter period, payable in arrears quarterly. As of October 31, 2016 there was no outstanding borrowing amount under the Credit Agreement.

In February 2015, we assumed a \$200.0 million loan with the acquisition of 50 Fremont (the “Loan”). The Loan bears an interest rate of 3.75% per annum and is due in June 2023. The Loan requires interest only payments with the remaining principal due at maturity. The Loan can be prepaid at any time subject to a yield maintenance fee. The agreement governing the Loan contains certain customary affirmative and negative covenants that we were in compliance with as of October 31, 2016.

In July 2016, we entered into a \$500.0 million term loan (the “Term Loan”) which matures in July 2019 and bears interest at our option, at either a base rate plus a spread of 0.00% to 0.75% or an adjusted LIBOR rate plus a spread of 1.00% to 1.75%, in each case with such spread being determined based on the Company’s consolidated leverage ratio for the preceding four fiscal quarter period. We entered into the Term Loan for purposes of partially funding the acquisition of Demandware. Interest is due and payable in arrears quarterly for loans bearing interest at a rate based on the base rate and at the end of an interest period in the case of loans bearing interest at the adjusted LIBOR rate. The

Term Loan is payable in July 2019, with the outstanding principal amount of the term loan being due and payable at maturity.

By entering into the Term Loan, we have assumed risks associated with variable interest rates based upon a variable base rate or LIBOR. The weighted average interest rate on the Term Loan was 1.8% as of October 31, 2016. Changes in the overall level of interest rates affect the interest expense that we recognize in our statements of operations. We deposit our cash with multiple financial institutions.



Table of Contents

The bank counterparties to our derivative contracts potentially expose us to credit-related losses in the event of their nonperformance. To mitigate that risk, we only contract with counterparties who meet the minimum requirements under our counterparty risk assessment process. We monitor ratings, credit spreads and potential downgrades on at least a quarterly basis. Based on our on-going assessment of counterparty risk, we adjust our exposure to various counterparties. We generally enter into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. However, we do not have any master netting arrangements in place with collateral features.

We have an investment portfolio that includes strategic investments in public and privately held companies, which range from early-stage companies to more mature companies with established revenue streams and business models. Our investments in privately held companies are primarily in preferred stock of the respective investees and therefore provide us with liquidation preferences in the event there are certain liquidation events. When our ownership interests are less than 20 percent and we do not have the ability to exert significant influence, we account for investments in non-marketable debt and equity securities of the privately held companies using the cost method of accounting. Otherwise, we account for the investments using the equity method of accounting.

Our portfolio consists of investments in over 170 privately held companies, primarily comprised of independent software vendors and system integrators. We invest in early-to-late stage enterprise cloud companies for strategic reasons and to support key business initiatives to grow our ecosystem of partners and accelerate the adoption of cloud technologies. We invest in both domestic and international companies and currently hold investments in all of our regions: the Americas, Europe, and Asia Pacific. Our investments in these companies range from \$0.2 million to over \$70.0 million, with 13 investments individually equal to or in excess of approximately \$10 million. As of October 31, 2016 and January 31, 2016 the carrying value of our investments in privately held companies was \$513.5 million and \$504.5 million, respectively. The estimated fair value of our investments in privately held companies was \$752.1 million and \$714.1 million as of October 31, 2016 and January 31, 2016, respectively. The financial success of our investment in any company is typically dependent on a liquidity event, such as a public offering, acquisition or other favorable market event reflecting appreciation to the cost of our initial investment. If we determine that any of our investments in such companies have experienced a decline in fair value, we may be required to record an impairment that is other than temporary, which could be material. We have in the past written off the full value of specific investments. Similar situations could occur in the future and negatively impact our financial results. All of our investments are subject to a risk of partial or total loss of investment capital.

**ITEM 4. CONTROLS AND PROCEDURES**

**(a) Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of the end of the period covered by this report.

In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management’s evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are designed to, and are effective to, provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures.

**(b) Management’s Report on Internal Control Over Financial Reporting**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recently completed fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there has not been any material change in our internal control over financial reporting during the quarter covered by this report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of business, we are or may be involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, corporate and securities, labor and employment, class actions, wage and hour, and other claims. We have been, and may in the future be put on notice and/or sued by third parties for alleged infringement of their proprietary rights, including patent infringement.

During fiscal 2015, we received a communication from a large technology company alleging that we infringed certain of its patents. No litigation has been filed to date. There can be no assurance that this claim will not lead to litigation in the future. The resolution of this claim is not expected to have a material adverse effect on our financial condition, but it could be material to operating results or cash flows or both of a particular quarter.

We evaluate all claims and lawsuits with respect to their potential merits, our potential defenses and counterclaims, settlement or litigation potential and the expected effect on us. Our technologies may be subject to injunction if they are found to infringe the rights of a third party. In addition, many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which could increase the cost to us of an adverse ruling on such a claim.

The outcome of any claims or litigation, regardless of the merits, is inherently uncertain. Any claims and other lawsuits, and the disposition of such claims and lawsuits, whether through settlement or litigation, could be time-consuming and expensive to resolve, divert our attention from executing our business plan, result in efforts to enjoin our activities, lead to attempts by third parties to seek similar claims and, in the case of intellectual property claims, require us to change our technology, change our business practices, pay monetary damages or enter into short- or long-term royalty or licensing agreements.

In general, the resolution of a legal matter could prevent us from offering our service to others, could be material to our financial condition or cash flows, or both, or could otherwise adversely affect our operating results.

We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of all current matters is not expected to have a material adverse impact on our consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, of a particular quarter.

ITEM 1A. RISK FACTORS

The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations, cash flows and financial condition.

Risks Related to Our Business and Industry

If our security measures or those of our third-party data center hosting facilities, cloud computing platform providers, or third-party service partners, are breached, and unauthorized access is obtained to a customer's data, our data or our IT systems, our services may be perceived as not being secure, customers may curtail or stop using our services, and we may incur significant legal and financial exposure and liabilities.

Our services involve the storage and transmission of our customers' and our customers' customers' proprietary and other sensitive data, including financial information and other personally identifiable information. Security breaches

could expose us to a risk of loss of this information, litigation and possible liability. While we have security measures in place, they may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise and result in someone obtaining unauthorized access to our IT data, our customers' data or our data, including our intellectual property and other confidential business information. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers' data, our data or our IT systems. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, our customers may authorize third-

Table of Contents

party technology providers to access their customer data, and some of our customers may not have adequate security measures in place to protect their data that is stored on our services. Because we do not control our customers or third-party technology providers, or the processing of such data by third-party technology providers, we cannot ensure the integrity or security of such transmissions or processing. Malicious third parties may also conduct attacks designed to temporarily deny customers access to our services. Any security breach could result in a loss of confidence in the security of our services, damage our reputation, negatively impact our future sales, disrupt our business and lead to legal liability.

Defects or disruptions in our services could diminish demand for our services and subject us to substantial liability. Because our services are complex and incorporate a variety of hardware and proprietary and third-party software, our services may have errors or defects that could result in unanticipated downtime for our subscribers and harm to our reputation and our business. Cloud services frequently contain undetected errors when first introduced or when new versions or enhancements are released. We have from time to time found defects in, and experienced disruptions to, our services and new defects or disruptions may occur in the future. In addition, our customers may use our services in unanticipated ways that may cause a disruption in services for other customers attempting to access their data. As we acquire companies, we may encounter difficulty in incorporating the acquired technologies into our services and maintaining the quality standards that are consistent with our brand and reputation. Since our customers use our services for important aspects of their business, any errors, defects, disruptions in service or other performance problems could hurt our reputation and may damage our customers' businesses. As a result, customers could elect to not renew our services or delay or withhold payment to us. We could also lose future sales or customers may make warranty or other claims against us, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or the expense and risk of litigation.

Interruptions or delays in services from our third-party data center hosting facilities or cloud computing platform providers could impair the delivery of our services and harm our business.

We currently serve our customers from third-party data center hosting facilities and cloud computing platform providers located in the United States and other countries. Any damage to, or failure of, our systems generally could result in interruptions in our services. We have from time to time experienced interruptions in our services and such interruptions may occur in the future. Interruptions in our services may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our attrition rates and our ability to attract new customers, all of which would reduce our revenue. Our business would also be harmed if our customers and potential customers believe our services are unreliable.

As part of our current disaster recovery and business continuity arrangements, our production environment and all of our customers' data are currently replicated in near real-time in a separate facility located elsewhere. Companies and products added through acquisition may be served through alternate facilities. We do not control the operation of any of these facilities, and they may be vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They may also be subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct, as well as local administrative actions, changes to legal or permitting requirements and litigation to stop, limit or delay operation. Despite precautions taken at these facilities, the occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice or other unanticipated problems at these facilities could result in lengthy interruptions in our services. Even with disaster recovery and business continuity arrangements, our services could be interrupted.

If we do not accurately plan for our infrastructure capacity requirements and we experience significant strains on our data center capacity, our customers could experience performance degradation or service outages that may subject us to financial liabilities, result in customer losses and harm our business. When we add data centers and add capacity, we may move or transfer our data and our customers' data. Despite precautions taken during this process, any unsuccessful data transfers may impair the delivery of our services, which may damage our business.

Our ability to deliver our services is dependent on the development and maintenance of the infrastructure of the Internet by third parties.

The Internet's infrastructure is comprised of many different networks and services that are highly fragmented and distributed by design. This infrastructure is run by a series of independent third party organizations that work together to provide the infrastructure and supporting services of the Internet under the governance of the Internet Corporation for Assigned Numbers and Names (ICANN) and the Internet Assigned Numbers Authority (IANA), now under the stewardship of ICANN.

The Internet has experienced a variety of outages and other delays as a result of damages to portions of its infrastructure, denial-of-service attacks or related cyber incidents, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage or result in fragmentation of the Internet, resulting in multiple separate Internets. These scenarios are not under our control and could reduce the availability of the Internet to us or our customers for delivery of our

Table of Contents

Internet-based services. Any resulting interruptions in our services or the ability of our customers to access our services could result in a loss of potential or existing customers and harm our business.

Privacy concerns and laws, evolving regulation of cloud computing, cross-border data transfer restrictions and other domestic or foreign regulations may limit the use and adoption of our services and adversely affect our business. Regulation related to the provision of services on the Internet is increasing, as federal, state and foreign governments continue to adopt new laws and regulations addressing data privacy and the collection, processing, storage and use of personal information. In some cases, foreign data privacy laws and regulations, such as the European Union's Data Protection Directive, and the country-specific laws and regulations that implement that directive, also govern the processing of personal information. Further, laws are increasingly aimed at the use of personal information for marketing purposes, such as the European Union's e-Privacy Directive, and the country-specific regulations that implement that directive. Such laws and regulations are subject to new and differing interpretations and may be inconsistent among jurisdictions. These and other requirements could reduce demand for our services or restrict our ability to store and process data or, in some cases, impact our ability to offer our services in certain locations or our customers' ability to deploy our solutions globally. For example, in October 2015, the European Court of Justice invalidated the U.S.-EU Safe Harbor framework that had been in place since 2000, which allowed companies to meet certain European legal requirements for the transfer of personal data from the European Economic Area to the United States. While other adequate legal mechanisms to lawfully transfer such data remain, the invalidation of the U.S.-EU Safe Harbor framework may result in different European data protection regulators applying differing standards for the transfer of personal data, which could result in increased regulation, cost of compliance and limitations on data transfer for us and our customers. The costs of compliance with and other burdens imposed by laws, regulations and standards may limit the use and adoption of our services, reduce overall demand for our services, lead to significant fines, penalties or liabilities for noncompliance, or slow the pace at which we close sales transactions, any of which could harm our business.

In addition to government activity, privacy advocacy and other industry groups have established or may establish new self-regulatory standards that may place additional burdens on us. Our customers expect us to meet voluntary certification or other standards established by third parties, such as TRUSTe. If we are unable to maintain these certifications or meet these standards, it could adversely affect our ability to provide our solutions to certain customers and could harm our business.

Furthermore, concerns regarding data privacy may cause our customers' customers to resist providing the data necessary to allow our customers to use our services effectively. Even the perception that the privacy of personal information is not satisfactorily protected or does not meet regulatory requirements could inhibit sales of our products or services, and could limit adoption of our cloud-based solutions.

Industry-specific regulation and other requirements and standards are evolving and unfavorable industry-specific laws, regulations, interpretive positions or standards could harm our business.

Our customers and potential customers conduct business in a variety of industries, including financial services, the public sector, healthcare and telecommunications. Regulators in certain industries have adopted and may in the future adopt regulations or interpretive positions regarding the use of cloud computing and other outsourced services. The costs of compliance with, and other burdens imposed by, industry-specific laws, regulations and interpretive positions may limit our customers' use and adoption of our services and reduce overall demand for our services. Compliance with these regulations may also require us to devote greater resources to support certain customers, which may increase costs and lengthen sales cycles. For example, some financial services regulators have imposed guidelines for use of cloud computing services that mandate specific controls or require financial services enterprises to obtain regulatory approval prior to outsourcing certain functions. If we are unable to comply with these guidelines or controls, or if our customers are unable to obtain regulatory approval to use our services where required, our business may be harmed. In addition, an inability to satisfy the standards of certain voluntary third-party certification bodies that our customers may expect, such as an attestation of compliance with the Payment Card Industry (PCI) Data Security Standards, may have an adverse impact on our business and results. Further, there are various statutes, regulations, and rulings relevant to the direct email marketing and text-messaging industries, including the Telephone Consumer Protection Act (TCPA) and related Federal Communication Commission (FCC) orders. The interpretation

of many of these statutes, regulations, and rulings is evolving in the courts and administrative agencies and an inability to comply may have an adverse impact on our business and results. If in the future we are unable to achieve or maintain industry-specific certifications or other requirements or standards relevant to our customers, it may harm our business and adversely affect our results.

In some cases, industry-specific laws, regulations or interpretive positions may also apply directly to us as a service provider. Any failure or perceived failure by us to comply with such requirements could have an adverse impact on our business.



Table of Contents

We rely on third-party computer hardware, software and cloud computing platforms that could cause errors in, or failures of, our services and may be difficult to replace.

We rely on computer hardware purchased or leased from, software licensed from, and cloud computing platforms provided by, third parties in order to offer our services, including database software and hardware from a variety of vendors. Any errors or defects in third-party hardware, software or cloud computing platforms could result in errors in, or a failure of, our services, which could harm our business. These hardware, software and cloud computing platforms may not continue to be available at reasonable prices, on commercially reasonable terms or at all. Any loss of the right to use any of these hardware, software or cloud computing platforms could significantly increase our expenses and otherwise result in delays in the provisioning of our services until equivalent technology is either developed by us, or, if available, is identified, obtained through purchase or license and integrated into our services. The market in which we participate is intensely competitive, and if we do not compete effectively, our operating results could be harmed.

The market for enterprise applications and platform services is highly competitive, rapidly evolving and fragmented, and subject to changing technology, shifting customer needs and frequent introductions of new products and services. We compete primarily with generalized platforms and vendors of packaged business software, as well as companies offering enterprise apps, including CRM, collaboration and business intelligence software. We also compete with internally developed apps and face competition from enterprise software vendors and online service providers who may develop toolsets and products that allow customers to build new applications that run on the customers' current infrastructure or as hosted services. Our current competitors include:

- on premise offerings from enterprise software application vendors;
- cloud computing application service providers, either individually or in alliance with each other;
- software companies that provide their product or service free of charge, and only charge a premium for advanced features and functionality;
- social media companies;
- traditional platform development environment companies;
- cloud computing development platform companies;
- internally developed applications (by our potential customers' IT departments); and

• IoT platforms from large companies that have existing relationships with hardware and software companies. Many of our current and potential competitors enjoy substantial competitive advantages, such as greater name recognition, longer operating histories and larger marketing budgets, as well as substantially greater financial, technical and other resources. In addition, many of our current and potential competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers. As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. Furthermore, because of these advantages, even if our services are more effective than the products and services that our competitors offer, potential customers might select competitive products and services in lieu of purchasing our services. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

As we acquire and invest in companies or technologies, we may not realize the expected business or financial benefits and the acquisitions could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results and the market value of our common stock.

As part of our business strategy, we periodically make investments in, or acquisitions of, complementary businesses, joint ventures, services and technologies and intellectual property rights, and we expect that we will continue to make such investments and acquisitions in the future. Acquisitions and investments involve numerous risks, including:

- potential failure to achieve the expected benefits of the combination or acquisition;
- difficulties in, and the cost of, integrating operations, technologies, services, platforms and personnel;
- diversion of financial and managerial resources from existing operations;
- the potential entry into new markets in which we have little or no experience or where competitors may have stronger market positions;

potential write-offs of acquired assets or investments, and potential financial and credit risks associated with acquired customers;  
potential loss of key employees of the acquired company;  
inability to generate sufficient revenue to offset acquisition or investment costs;

76

---

Table of Contents

- inability to maintain relationships with customers and partners of the acquired business;
- difficulty of transitioning the acquired technology onto our existing platforms and customer acceptance of multiple platforms on a temporary or permanent basis;
- increasing or maintaining the security standards for acquired technology consistent with our other services;
- potential unknown liabilities associated with the acquired businesses;
- unanticipated expenses related to acquired technology and its integration into our existing technology;
- negative impact to our results of operations because of the depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation; additional stock based compensation; and the loss of acquired deferred revenue and unbilled deferred revenue;
- delays in customer purchases due to uncertainty related to any acquisition;
- the need to implement controls, procedures and policies at the acquired company;
- challenges caused by integrating operations over distance, and across different languages and cultures;
- currency and regulatory risks associated with foreign countries and potential additional cybersecurity and compliance risks resulting from entry into new markets; and
- the tax effects of any such acquisitions.

Any of these risks could harm our business. In addition, to facilitate these acquisitions or investments, we may seek additional equity or debt financing, which may not be available on terms favorable to us or at all, which may affect our ability to complete subsequent acquisitions or investments, and which may affect the risks of owning our common stock. For example, if we finance acquisitions by issuing equity or convertible or other debt securities or loans, our existing stockholders may be diluted, or we could face constraints related to the terms of and repayment obligation related to the incurrence of indebtedness that could affect the market price of our common stock.

We are subject to risks associated with our strategic investments. Other-than-temporary impairments in the value of our investments could negatively impact our financial results.

We invest in early-to-late stage companies for strategic reasons and to support key business initiatives, and may not realize a return on our strategic investments. Many such companies generate net losses and the market for their products, services or technologies may be slow to develop, and, therefore, are dependent on the availability of later rounds of financing from banks or investors on favorable terms to continue their operations. The financial success of our investment in any company is typically dependent on a liquidity event, such as a public offering, acquisition or other favorable market event reflecting appreciation to the cost of our initial investment. The capital markets for public offerings and acquisitions are dynamic and the likelihood of liquidity events for the companies we have invested in could significantly worsen. Further, valuations of privately-held companies are inherently complex due to the lack of readily available market data. If we determine that any of our investments in such companies have experienced a decline in value, we may be required to record an other than temporary impairment, which could be material. We have in the past written off the full value of specific investments. Similar situations could occur in the future and negatively impact our financial results. All of our investments are subject to a risk of a partial or total loss of investment capital.

Our quarterly results are likely to fluctuate and our stock price and the value of our common stock could decline substantially.

Our quarterly results are likely to fluctuate. For example, our fiscal fourth quarter has historically been our strongest quarter for new business and renewals. The year-over-year compounding effect of this seasonality in billing patterns and overall new business and renewal activity causes the value of invoices that we generate in the fourth quarter to continually increase in proportion to our billings in the other three quarters of our fiscal year. As a result, our fiscal first quarter is our largest collections and operating cash flow quarter.

Additionally, some of the important factors that may cause our revenues, operating results and cash flows to fluctuate from quarter to quarter include:

- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' requirements;
- the attrition rates for our services;
-

the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;  
changes in deferred revenue and unbilled deferred revenue balances, which are not reflected in the balance sheet, due to seasonality, the compounding effects of renewals, invoice duration, size and timing, new business linearity between quarters and within a quarter and fluctuations due to foreign currency movements;

77

---

Table of Contents

the seasonality of our customers' businesses, especially Commerce Cloud customers, including retailers and branded manufacturers;

changes in foreign currency exchange rates such as with respect to the British Pound;

variations in the revenue mix of our services and growth rates of our cloud subscription and support offerings;

the number of new employees;

changes in our pricing policies and terms of contracts, whether initiated by us or as a result of competition;

the cost, timing and management effort for the introduction of new features to our services;

- the costs associated with acquiring new businesses and technologies and the follow-on costs of integration and consolidating the results of acquired businesses;

the rate of expansion and productivity of our sales force;

the length of the sales cycle for our services;

new product and service introductions by our competitors;

our success in selling our services to large enterprises;

evolving regulations of cloud computing and cross-border data transfer restrictions and similar regulations;

- technical difficulties or interruptions in our services;

expenses related to our real estate, our office leases and our data center capacity and expansion;

changes in interest rates and our mix of investments, which would impact the return on our investments in cash and marketable securities;

conditions, particularly sudden changes, in the financial markets, which have impacted and may continue to impact the value of and liquidity of our investment portfolio;

income tax effects;

our ability to realize benefits from strategic partnerships, acquisition or investments;

other than temporary impairments in the value of our strategic investments in early-to-late stage privately held companies, which could be material in a particular quarter;

expenses related to significant, unusual or discrete events, which are recorded in the period in which the events occur;

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

timing of additional investments in our enterprise cloud computing application and platform services and in our consulting services;

regulatory compliance costs;

changes in payment terms and the timing of customer payments and payment defaults by customers;

extraordinary expenses such as litigation or other dispute-related settlement payments;

- the impact of new accounting pronouncements, for example, the adoption of ASU 2016-09, which involves employee share-based payment accounting, and the volatility of the effective tax rate;

equity issuances, including as consideration in acquisitions or due to the conversion of our outstanding convertible notes at the election of the note holders;

the timing of stock awards to employees and the related adverse financial statement impact of having to expense those stock awards on a straight-line basis over their vesting schedules;

the timing of commission, bonus, and other compensation payments to employees; and

the timing of payroll and other withholding tax expenses, which are triggered by the payment of bonuses and when employees exercise their vested stock awards.

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

Additionally, if we fail to meet or exceed the expectations of securities analysts and investors, or if one or more of the securities analysts who cover us adversely change their recommendation regarding our stock, the market price of our

common

78

---

Table of Contents

stock could decline. Moreover, our stock price may be based on expectations, estimates and forecasts of our future performance that may be unrealistic or that may not be met. Further, our stock price may fluctuate based on reporting by the financial media, including television, radio and press reports and blogs.

If we experience significant fluctuations in our rate of anticipated growth and fail to balance our expenses with our revenue forecasts, our results could be harmed.

Due to the pace of change and innovation in enterprise cloud computing services and the unpredictability of future general economic and financial market conditions and the impact of foreign currency exchange rate fluctuations, we may not be able to accurately forecast our rate of growth. We plan our expense levels and investment on estimates of future revenue and future anticipated rate of growth. We may not be able to adjust our spending appropriately if the addition of new subscriptions or the renewals of existing subscriptions fall short of our expectations. A portion of our expenses may also be fixed in nature for some minimum amount of time, such as with a data center contract or office lease, so it may not be possible to reduce costs in a timely manner or without the payment of fees to exit certain obligations early. As a result, we expect that our revenues, operating results and cash flows may fluctuate significantly on a quarterly basis. Our recent revenue growth rates may not be sustainable and may decline in the future. We believe that historical period-to-period comparisons of our revenues, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

Our efforts to expand our services beyond the CRM market and to develop our existing services in order to keep pace with technological developments may not succeed and may reduce our revenue growth rate and harm our business. We derive substantially all of our revenue from subscriptions to our CRM enterprise cloud computing application services, and we expect this will continue for the foreseeable future. The markets for our Analytics, Communities, IoT and Commerce Clouds remain relatively new and it is uncertain whether our efforts will ever result in significant revenue for us. Commerce Cloud originated as part of our Demandware acquisition. Further, the introduction of significant platform changes and upgrades, including our conversion to our new Lightning platform, and introduction of new services beyond the CRM market, may not be successful, and early stage interest and adoption of such new services may not result in long term success or significant revenue for us. Our efforts to expand our services beyond the CRM market may not succeed and may reduce our revenue growth rate.

Additionally, if we are unable to develop enhancements to and new features for our existing or new services that keep pace with rapid technological developments, our business will be harmed. The success of enhancements, new features and services depends on several factors, including the timely completion, introduction and market acceptance of the feature, service or enhancement. Failure in this regard may significantly impair our revenue growth. In addition, because our services are designed to operate on a variety of network hardware and software platforms using a standard browser, we will need to continuously modify and enhance our services to keep pace with changes in Internet-related hardware, software, communication, browser and database technologies. We may not be successful in either developing these modifications and enhancements or in bringing them to market timely. Furthermore, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies, could increase our research and development or service delivery expenses. Any failure of our services to operate effectively with future network platforms and technologies could reduce the demand for our services, result in customer dissatisfaction and harm our business.

Additionally, if we fail to anticipate or identify significant Internet-related and other technology trends and developments early enough, or if we do not devote appropriate resources to adapting to such trends and developments, our business could be harmed.

Sales to customers outside the United States expose us to risks inherent in international sales.

We sell our services throughout the world and are subject to risks and challenges associated with international business. Historically, sales in Europe and Asia Pacific together have represented approximately 30 percent of our total revenues, and we intend to continue to expand our international sales efforts. The risks and challenges associated with sales to customers outside the United States, as well as international operations generally, include:

- localization of our services, including translation into foreign languages and associated expenses;
- laws and business practices favoring local competitors;

pressure on the creditworthiness of sovereign nations, particularly in Europe, where we have customers and a balance of our cash, cash equivalents and marketable securities;  
liquidity issues or political actions by sovereign nations, which could result in decreased values of these balances;  
foreign currency fluctuations and controls;

79

---



Table of Contents

compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy, anti-corruption, import/export, antitrust, data transfer, storage and protection, and industry-specific laws and regulations, including rules related to compliance by our third-party resellers;

regional data privacy laws and other regulatory requirements that apply to outsourced service providers and to the transmission of our customers' data across international borders;

treatment of revenue from international sources and changes to tax codes, including being subject to foreign tax laws and being liable for paying withholding income or other taxes in foreign jurisdictions;

different pricing environments;

difficulties in staffing and managing foreign operations;

different or lesser protection of our intellectual property;

longer accounts receivable payment cycles and other collection difficulties;

natural disasters, acts of war, terrorism, pandemics or security breaches; and

regional economic and political conditions.

Any of these factors could negatively impact our business and results of operations. The above factors may also negatively impact our ability to successfully expand into emerging market countries, where we have little or no operating experience, where it can be costly and challenging to establish and maintain operations, including hiring and managing required personnel, and difficult to promote our brand, and where we may not benefit from any first-to-market advantage or otherwise succeed.

Additionally, our international subscription fees are paid either in U.S. Dollars or local currency. As a result, fluctuations in the value of the U.S. Dollar and foreign currencies may make our services more expensive for international customers, which could harm our business.

Because we recognize revenue from subscriptions for our services over the term of the subscription, downturns or upturns in new business may not be immediately reflected in our operating results.

We generally recognize revenue from customers ratably over the terms of their subscription agreements, which are typically 12 to 36 months. As a result, most of the revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any one quarter may not be reflected in our revenue results for that quarter. Any such decline, however, will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our services, and potential changes in our attrition rate, may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

If our customers do not renew their subscriptions for our services or reduce the number of paying subscriptions at the time of renewal, our revenue will decline and our business will suffer. If we cannot accurately predict subscription renewals or upgrade rates, we may not meet our revenue targets which may adversely affect the market price of our common stock.

Our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period, which is typically 12 to 36 months, and in the normal course of business, some customers have elected not to renew. In addition, our customers may renew for fewer subscriptions, renew for shorter contract lengths, or switch to lower cost offerings of our services. We cannot accurately predict attrition rates given our varied customer base of enterprise and small and medium size business customers and the number of multi-year subscription contracts. Our attrition rates may increase or fluctuate as a result of a number of factors, including customer dissatisfaction with our services, customers' spending levels, decreases in the number of users at our customers, pricing increases or changes and deteriorating general economic conditions.

Our future success also depends in part on our ability to sell additional features and services, more subscriptions or enhanced editions of our services to our current customers. This may also require increasingly sophisticated and costly sales efforts that are targeted at senior management. Similarly, the rate at which our customers purchase new or enhanced services depends on a number of factors, including general economic conditions and that our customers do not react negatively to any price changes related to these additional features and services. If our efforts to upsell to our

customers are not successful our business may suffer.

If the market for our technology delivery model and enterprise cloud computing services develops more slowly than we expect, our business could be harmed.

Our success depends on the willingness of third-party developers to build applications that are complementary to our services. Without the development of these applications, both current and potential customers may not find our services

80

---

Table of Contents

sufficiently attractive. In addition, for those customers who authorize a third-party technology partner access to their data, we do not provide any warranty related to the functionality, security and integrity of the data transmission or processing. Despite contract provisions to protect us, customers may look to us to support and provide warranties for the third-party applications, which may expose us to potential claims, liabilities and obligations for applications we did not develop or sell, all of which could harm our business.

We are exposed to fluctuations in currency exchange rates that could negatively impact our financial results and cash flows from changes in the value of the U.S. Dollar versus local currencies.

We conduct our business in the following locations: United States, Europe, Canada, Asia Pacific and Japan. The expanding global scope of our business exposes us to risk of fluctuations in foreign currency markets. This exposure is the result of selling in multiple currencies, growth in our international investments, including data center expansion, additional headcount in foreign locations, and operating in countries where the functional currency is the local currency. Specifically, our results of operations and cash flows are subject to fluctuations primarily in British Pound Sterling, the Euro and Japanese Yen against the U.S. Dollar. These exposures may change over time as business practices evolve and economic conditions change, including, for example, sudden global economic conditions resulting from measures like the referendum in the United Kingdom in June 2016, which resulted in a vote in favor of exiting the European Union (“Brexit”). The fluctuations of currencies in which we conduct business can both increase and decrease our overall revenue and expenses for any given fiscal period. Such volatility, even when it increases our revenues or decreases our expenses, impacts our ability to accurately predict our future results and earnings.

Supporting our existing and growing customer base could strain our personnel resources and infrastructure, and if we are unable to scale our operations and increase productivity, we may not be able to successfully implement our business plan.

We continue to experience significant growth in our customer base and personnel, which has placed a strain on our management, administrative, operational and financial infrastructure. We anticipate that additional investments in our internal infrastructure, data center capacity, research, customer support and development, and real estate spending will be required to scale our operations and increase productivity, to address the needs of our customers, to further develop and enhance our services, to expand into new geographic areas, and to scale with our overall growth. The additional investments we are making will increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term.

We regularly upgrade or replace our various software systems. If the implementations of these new applications are delayed, or if we encounter unforeseen problems with our new systems or in migrating away from our existing applications and systems, our operations and our ability to manage our business could be negatively impacted.

Our success will depend in part upon the ability of our senior management to manage our projected growth effectively. To do so, we must continue to increase the productivity of our existing employees and to hire, train and manage new employees as needed. To manage the expected domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls, our reporting systems and procedures, and our utilization of real estate. If we fail to successfully scale our operations and increase productivity, we will be unable to execute our business plan.

As more of our sales efforts are targeted at larger enterprise customers, our sales cycle may become more time-consuming and expensive, we may encounter pricing pressure and implementation and customization challenges, and we may have to delay revenue recognition for some complex transactions, all of which could harm our business and operating results.

As we target more of our sales efforts at larger enterprise customers, including governmental entities, we may face greater costs, longer sales cycles, greater competition and less predictability in completing some of our sales. In this market segment, the customer’s decision to use our services may be an enterprise-wide decision and, if so, these types of sales would require us to provide greater levels of education regarding the use and benefits of our services, as well as education regarding privacy and data protection laws and regulations to prospective customers with international operations. In addition, larger customers and governmental entities may demand more customization, integration services and features. As a result of these factors, these sales opportunities may require us to devote greater sales support and professional services resources to individual customers, driving up costs and time required to complete

sales and diverting our own sales and professional services resources to a smaller number of larger transactions, while potentially requiring us to delay revenue recognition on some of these transactions until the technical or implementation requirements have been met.

Pricing and packaging strategies for enterprise and other customers for subscriptions to our existing and future service offerings may not be widely accepted by other new or existing customers. Our adoption of such new pricing and packaging strategies may harm our business.

81

---

Table of Contents

For large enterprise customers, professional services may also be performed by a third party or a combination of our own staff and a third party. Our strategy is to work with third parties to increase the breadth of capability and depth of capacity for delivery of these services to our customers. If a customer is not satisfied with the quality of work performed by us or a third party or with the type of services or solutions delivered, then we could incur additional costs to address the situation, the profitability of that work might be impaired, and the customer's dissatisfaction with our services could damage our ability to obtain additional work from that customer. In addition, negative publicity related to our customer relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new business with current and prospective customers.

We have been and may in the future be sued by third parties for various claims including alleged infringement of proprietary rights.

We are involved in various legal matters arising from the normal course of business activities. These may include claims, suits, government investigations and other proceedings involving alleged infringement of third-party patents and other intellectual property rights, commercial, corporate and securities, labor and employment, class actions, wage and hour, and other matters.

The software and Internet industries are characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received in the past and may receive in the future communications from third parties, including practicing entities and non-practicing entities, claiming that we have infringed their intellectual property rights. In addition, we have been, and may in the future be, sued by third parties for alleged infringement of their claimed proprietary rights. For example, during fiscal 2015, we received a communication from a large technology company alleging that we infringed certain of its patents. While we continue to analyze this claim and no litigation has been filed to date, there can be no assurance that this claim will not lead to litigation in the future. Our technologies may be subject to injunction if they are found to infringe the rights of a third party or we may be required to pay damages, or both. Further, many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim.

The outcome of any claims or litigation, regardless of the merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, whether through settlement or licensing discussions, or litigation, could be time-consuming and expensive to resolve, divert management attention from executing our business plan, result in efforts to enjoin our activities, lead to attempts on the part of other parties to pursue similar claims and, in the case of intellectual property claims, require us to change our technology, change our business practices, pay monetary damages or enter into short- or long-term royalty or licensing agreements.

Any adverse determination related to intellectual property claims or other litigation could prevent us from offering our services to others, could be material to our financial condition or cash flows, or both, or could otherwise adversely affect our operating results. In addition, depending on the nature and timing of any such dispute, an unfavorable resolution of a legal matter could materially affect our future results of operations or cash flows or both of a particular quarter.

In addition, our exposure to risks associated with various claims, including the use of intellectual property, may be increased as a result of acquisitions of other companies. For example, we may have a lower level of visibility into the development process with respect to intellectual property or the care taken to safeguard against infringement risks with respect to the acquired company or technology. In addition, third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to our acquisition.

Table of Contents

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

If we fail to protect our intellectual property rights adequately, our competitors may gain access to our technology, and our business may be harmed. In addition, defending our intellectual property rights may entail significant expense. Any of our patents, trademarks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. While we have some U.S. patents and many U.S. and international patent applications pending, we may be unable to obtain patent protection for the technology covered in our patent applications or the patent protection may not be obtained quickly enough to meet our business needs. In addition, our existing patents and any patents issued in the future may not provide us with competitive advantages, or may be successfully challenged by third parties. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain, and we also may face proposals to change the scope of protection for some intellectual property rights in the U.S. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our services are available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the U.S., and mechanisms for enforcement of intellectual property rights may be inadequate. Also, our involvement in standard setting activity or the need to obtain licenses from others may require us to license our intellectual property. Accordingly, despite our efforts, we may be unable to prevent third parties from using our intellectual property.

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

Our continued success depends on our ability to maintain and enhance our brands.

We believe that the brand identities we have developed have significantly contributed to the success of our business. Maintaining and enhancing the Salesforce brand and our other brands are critical to expanding our base of customers, partners and employees. Our brand strength will depend largely on our ability to remain a technology leader and continue to provide high-quality innovative products, services, and features. In order to maintain and enhance our brands, we may be required to make substantial investments that may later prove to be unsuccessful. In addition, positions the Company takes on social issues may be unpopular with some customers or potential customers, which may impact our ability to attract or retain such customers. If we fail to maintain and enhance our brands, or if we incur excessive expenses in our efforts to do so, our business, operating results and financial condition may be materially and adversely affected.

We may lose key members of our management team or development and operations personnel, and may be unable to attract and retain employees we need to support our operations and growth.

Our success depends substantially upon the continued services of our executive officers and other key members of management, particularly our Chief Executive Officer. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives. Such changes in our executive management team may be disruptive to our business. We are also substantially dependent on the continued service of our existing development and operations personnel because of the complexity of our services and technologies. We do not have employment agreements with any of our executive officers, key management, development or operations personnel and they could terminate their employment with us at any time. The loss of one or more of our key employees or groups could seriously harm our business.

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

In addition, we believe in the importance of our corporate culture, or Aloha spirit, which fosters dialogue, collaboration, recognition and a sense of family. As our organization grows, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

Table of Contents

Any failure in our delivery of high-quality technical support services may adversely affect our relationships with our customers and our financial results.

Our customers depend on our support organization to resolve technical issues relating to our applications. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services. Increased customer demand for these services, without corresponding revenues, could increase costs and adversely affect our operating results. In addition, our sales process is highly dependent on our applications and business reputation and on positive recommendations from our existing customers. Any failure to maintain high-quality technical support, or a market perception that we do not maintain high-quality support, could adversely affect our reputation, our ability to sell our enterprise cloud computing solutions to existing and prospective customers, and our business, operating results and financial position.

Periodic changes to our sales organization can be disruptive and may reduce our rate of growth.

We periodically change and make adjustments to our sales organization in response to market opportunities, competitive threats, management changes, product introductions or enhancements, acquisitions, sales performance, increases in sales headcount, cost levels and other internal and external considerations. Any such future sales organization changes may result in a temporary reduction of productivity, which could negatively affect our rate of growth. In addition, any significant change to the way we structure our compensation of our sales organization may be disruptive and may affect our revenue growth.

Unanticipated changes in our effective tax rate and additional tax liabilities may impact our financial results.

We are subject to income taxes in the United States and various jurisdictions outside of the United States. Our effective tax rate could fluctuate due to changes in the mix of earnings and losses in countries with differing statutory tax rates. Our tax expense could also be impacted by changes in non-deductible expenses, changes in excess tax benefits of stock-based compensation, changes in the valuation of deferred tax assets and liabilities and our ability to utilize them, the applicability of withholding taxes and effects from acquisitions.

We are subject to tax examinations in multiple jurisdictions. While we regularly evaluate new information that may change our judgment resulting in recognition, derecognition or change in measurement of a tax position taken, there can be no assurance that the final determination of any examinations will not have an adverse effect on our operating results and financial position.

Our tax provision could also be impacted by changes in accounting principles, changes in U.S federal and state or international tax laws applicable to corporate multinationals such as the legislation recently enacted in the United Kingdom and Australia, other fundamental law changes currently being considered by many countries and changes in taxing jurisdictions' administrative interpretations, decisions, policies and positions. Additionally, in October 2015, the Organisation for Economic Co-Operation and Development released final guidance covering various topics, including transfer pricing, country-by-country reporting and definitional changes to permanent establishment which could ultimately impact our tax liabilities.

We may also be subject to additional tax liabilities due to changes in non-income taxes resulting from changes in federal, state or international tax laws, changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions, results of tax examinations, settlements or judicial decisions, changes in accounting principles, changes to the business operations, including acquisitions, as well as the evaluation of new information that results in a change to a tax position taken in a prior period.

Our debt service obligations and operating lease commitments may adversely affect our financial condition and cash flows from operations.

We have a high level of debt, including the 0.25% convertible senior notes we issued in March 2013 (the "0.25% Senior Notes") due April 1, 2018, the loan we assumed when we purchased 50 Fremont, and capital lease arrangements. Additionally, we have significant contractual commitments in operating lease arrangements, which are not reflected on our consolidated balance sheets. In addition, we have a financing obligation for a leased facility of which we are deemed the owner for accounting purposes. In July 2016, we amended and restated our revolving credit facility under which we can draw down up to \$1.0 billion. As of October 31, 2016, there were no outstanding borrowings under this credit facility. Also in July 2016, we entered into the \$500.0 million term loan to finance our acquisition of Demandware. Our maintenance of this indebtedness and any additional issuance of indebtedness could:



impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes;

cause us to dedicate a substantial portion of our cash flows from operations towards debt service obligations and principal repayments;

- make us more vulnerable to downturns in our business, our industry or the economy in general;
- and
- due to limitations within the revolving credit facility covenants, restrict our ability to incur additional indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter

Table of Contents

into transactions with affiliates, pay dividends or make distributions, repurchase stock and enter into restrictive agreements, as defined in the credit agreement.

Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. We will not be able to control many of these factors, such as economic conditions and governmental regulations. Further, our operations may not generate sufficient cash to enable us to service our debt or contractual obligations resulting from our leases. If we fail to make a payment on our debt, we could be in default on such debt. If we are at any time unable to generate sufficient cash flows from operations to service our indebtedness when payment is due, we may be required to attempt to renegotiate the terms of the instruments relating to the indebtedness, seek to refinance all or a portion of the indebtedness or obtain additional financing. There can be no assurance that we would be able to successfully renegotiate such terms, that any such refinancing would be possible or that any additional financing could be obtained on terms that are favorable or acceptable to us.

A failure to comply with the covenants and other provisions of our outstanding debt could result in events of default under such instruments, which could permit acceleration of all of our notes and borrowings under our revolving credit facility. Any required repayment of our notes or revolving credit facility as a result of a fundamental change or other acceleration would lower our current cash on hand such that we would not have those funds available for use in our business.

The new lease accounting guidance places operating lease activity on our consolidated balance sheet in fiscal 2020, which results in an increase in both our assets and financing obligations. The implementation of this guidance may impact our ability to obtain the necessary financing from financial institutions at commercially viable rates or at all as this new guidance will result in a higher financing obligation on our consolidated balance sheet.

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

Our overall performance depends in part on worldwide economic conditions. The United States and other key international economies have experienced cyclical downturns from time to time in which economic activity was impacted by falling demand for a variety of goods and services, restricted credit, poor liquidity, reduced corporate profitability, volatility in credit, equity and foreign exchange markets, bankruptcies and overall uncertainty with respect to the economy. These economic conditions can arise suddenly and the full impact of such conditions can remain uncertain. For example, increased uncertainty in the wake of Brexit has resulted in increased volatility in the global financial markets and the impact of Brexit on the global economy in 2016 and beyond remains uncertain. Moreover, these conditions can affect the rate of information technology spending and could adversely affect our customers' ability or willingness to purchase our enterprise cloud computing services, delay prospective customers' purchasing decisions, reduce the value or duration of their subscription contracts, or affect attrition rates, all of which could adversely affect our operating results.

Natural disasters and other events beyond our control could materially adversely affect us.

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control. Although we maintain crisis management and disaster response plans, such events could make it difficult or impossible for us to deliver our services to our customers, and could decrease demand for our services. The majority of our research and development activities, corporate headquarters, information technology systems, and other critical business operations, are located near major seismic faults in the San Francisco Bay Area. Because we do not carry earthquake insurance for direct quake-related losses, with the exception of the building that we own in San Francisco, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

**Risks Relating to Our Convertible Senior Notes and Our Common Stock**

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

The trading prices of the securities of technology companies have been highly volatile. Accordingly, the market price of our notes and common stock has been and is likely to continue to be subject to wide fluctuations. Factors affecting the market price of our notes and common stock include:

variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue, year-over-year growth rates for individual core service offerings and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;

- variations in, and limitations of, the various financial and other metrics and modeling used by analysts in their research and reports about our business;

forward-looking guidance to industry and financial analysts related to future revenue and earnings per share;

85

---

Table of Contents

changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;

announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;

announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;

announcements of customer additions and customer cancellations or delays in customer purchases;

recruitment or departure of key personnel;

disruptions in our service due to computer hardware, software, network or data center problems;

the economy as a whole, market conditions in our industry and the industries of our customers;

trading activity by a limited number of stockholders who together beneficially own a significant portion of our outstanding common stock;

the issuance of shares of common stock by us, whether in connection with an acquisition, a capital raising transaction or upon conversion of some or all of our outstanding convertible senior notes; and

issuance of debt or other convertible securities.

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

We may issue additional shares of our common stock or instruments convertible into shares of our common stock, including in connection with the conversion of the notes, and thereby materially and adversely affect the market price of our common stock and the trading price of the notes.

We are not restricted from issuing additional shares of our common stock or other instruments convertible into, or exchangeable or exercisable for, shares of our common stock during the life of the notes. If we issue additional shares of our common stock or instruments convertible into shares of our common stock, it may materially and adversely affect the market price of our common stock and, in turn, the trading price of the notes. In addition, the conversion of some or all of the notes may dilute the ownership interests of existing holders of our common stock, and any sales in the public market of any shares of our common stock issuable upon such conversion of the notes could adversely affect the prevailing market price of our common stock. In addition, the potential conversion of the notes could depress the market price of our common stock.

We may not have the ability to raise the funds necessary to pay the amount of cash due upon conversion of the notes or the fundamental change purchase price due when a holder submits its notes for purchase upon the occurrence of a fundamental change.

Upon the occurrence of a fundamental change, holders of the notes may require us to purchase, for cash, all or a portion of their notes. In addition, if a holder converts its notes, we will generally pay such holder an amount of cash before delivering to such holder any shares of our common stock.

There can be no assurance that we will have sufficient financial resources, or will be able to arrange financing, to pay the fundamental change purchase price if holders submit their notes for purchase by us upon the occurrence of a fundamental change or to pay the amount of cash due if holders surrender their notes for conversion. In addition, agreements governing any future debt may restrict our ability to make each of the required cash payments even if we have sufficient funds to make them. Furthermore, our ability to purchase the notes or to pay cash upon the conversion of the notes may be limited by law or regulatory authority. If we fail to purchase the notes, to pay interest due on the notes, or to pay the amount of cash due upon conversion, we will be in default under the indenture, which in turn may result in the acceleration of other indebtedness we may then have. If the repayment of the other indebtedness were to be accelerated, we may not have sufficient funds to repay that indebtedness and to purchase the notes or to pay the amount of cash due upon conversion. Our inability to pay for the notes that are tendered for purchase or upon

conversion could result in note holders receiving substantially less than the principal amount of the notes, which could harm our reputation, financing opportunities and our business.

The fundamental change provisions may delay or prevent an otherwise beneficial takeover attempt of us.

The fundamental change purchase rights will allow holders of the notes to require us to purchase all or a portion of their notes upon the occurrence of a fundamental change. The provisions requiring an increase to the conversion rate for conversions in connection with a make-whole fundamental change may, in certain circumstances, delay or prevent a takeover of us and the removal of incumbent management that might otherwise be beneficial to investors.

Table of Contents

The convertible note hedges and warrant transactions may affect the trading price of the notes and the market price of our common stock.

We entered into privately negotiated convertible note hedge transactions with certain hedge counterparties concurrently with the pricing of the notes. We also entered into privately negotiated warrant transactions with the hedge counterparties. Taken together, the convertible note hedge transactions and the warrant transactions are expected, but not guaranteed, to reduce the potential dilution with respect to our common stock upon conversion of the notes. If, however, the price of our common stock, as measured under the terms of the warrant transactions, exceeds the exercise price of the warrant transactions, the warrant transactions will have a dilutive effect on our earnings per share to the extent that the price of our common stock as measured under the warrant transactions exceeds the strike price of the warrant transactions.

The hedge counterparties and their respective affiliates periodically modify their hedge positions from time to time following the pricing of the notes (and are particularly likely to do so during any observation period relating to a conversion of the notes) by entering into or unwinding various over-the-counter derivative transactions with respect to our common stock, or by purchasing or selling shares of our common stock or the notes in privately negotiated transactions or open market transactions. The effect, if any, of these transactions and activities on the market price of our common stock or the trading price of the notes will depend in part on market conditions and cannot be ascertained at this time. Any of these activities, however, could adversely affect the market price of our common stock and the trading price of the notes.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the notes or our common stock. In addition, we do not make any representation that the counterparties to those transactions will engage in these transactions or activities or that these transactions and activities, once commenced, will not be discontinued without notice; the counterparties or their affiliates may choose to engage in, or discontinue engaging in, any of these transactions or activities with or without notice at any time, and their decisions will be in their sole discretion and not within our control.

We are subject to counterparty risk with respect to the convertible note hedge transactions.

The hedge counterparties are financial institutions or affiliates of financial institutions, and we will be subject to the risk that these hedge counterparties may default under the convertible note hedge transactions. Our exposure to the credit risk of the hedge counterparties will not be secured by any collateral. If one or more of the hedge counterparties to one or more of our convertible note hedge transactions becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at the time under those transactions.

Our exposure will depend on many factors but, generally, the increase in our exposure will be correlated to the increase in our stock price and the volatility of our stock. In addition, upon a default by one of the hedge counterparties, we may suffer adverse tax consequences and dilution with respect to our common stock. We can provide no assurances as to the financial stability or viability of any of the hedge counterparties.

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

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

- permit the board of directors to establish the number of directors;
- provide that directors may only be removed with the approval of holders of 66 2/3 percent of our outstanding capital stock;
- require super-majority voting to amend some provisions in our amended and restated certificate of incorporation and bylaws;
- authorize the issuance of “blank check” preferred stock that our board could use to implement a stockholder rights plan (also known as a “poison pill”);
- prohibit the ability of our stockholders to call special meetings of stockholders;

prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;

provide that the board of directors is expressly authorized to make, alter or repeal our bylaws; and

establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

Table of Contents

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

In addition, the fundamental change purchase rights applicable to the notes, which will allow note holders to require us to purchase all or a portion of their notes upon the occurrence of a fundamental change, and the provisions requiring an increase to the conversion rate for conversions in connection with a make-whole fundamental change, may in certain circumstances delay or prevent a takeover of us and the removal of incumbent management that might otherwise be beneficial to investors.



Table of Contents

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

The following table sets forth purchases of the Company's securities by the Company during the third quarter of fiscal 2017.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
August 1 to 31, 2016	0	\$ 0	0	0
September 1 to 30, 2016	0	\$ 0	0	0
October 1 to 31, 2016	3,415	\$ 1.84	0	0
Total	3,415	\$ 1.84	0	

(1) All of the shares purchased in October 2016 were repurchased from former employees of RelateIQ, Inc. ("RelateIQ") upon their termination of employment with the Company. The shares were originally acquired by the employees upon early exercise of RelateIQ stock options and were held subject to a right of repurchase in favor of the issuer until the satisfaction of certain vesting requirements.

(2) The price paid per share was the original option exercise price per share paid by the former RelateIQ employees upon early exercise, as adjusted pursuant to the terms of the agreement by which the Company acquired RelateIQ.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

Not applicable.

## ITEM 6. EXHIBITS

The documents listed in the Index to Exhibits of this quarterly report on Form 10-Q are incorporated by reference or are filed with this quarterly report on Form 10-Q, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 21, 2016

salesforce.com, inc.

By: /S/ MARK J. HAWKINS  
Mark J. Hawkins  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

Dated: November 21, 2016

salesforce.com, inc.

By: /S/ JOE ALLANSON  
Joe Allanson  
Executive Vice President,  
Chief Accounting Officer  
and Corporate Controller  
(Principal Accounting Officer)

Table of Contents

## Index to Exhibits

Exhibit No.	Exhibit Description	Provided Herewith	Incorporated by Reference Form SEC File No.	Exhibit	Filing Date
3.1	Amended and Restated Certificate of Incorporation of salesforce.com, inc.		8-K 001-32224	3.1	06/03/2016
3.2	Amended and Restated Bylaws of salesforce.com, inc.		8-K 001-32224	3.2	03/21/2016
10.1	2014 Inducement Equity Incentive Plan, as amended and restated effective September 8, 2016, and related forms of equity awards		S-8 333-213685	4.3	09/16/2016
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X			
101.INS	XBRL Instance Document				
101.SCH	XBRL Taxonomy Extension Schema Document				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				
101.DEF	XBRL Extension Definition Linkbase Document				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				